

# EVOLUTION OF THE ROMANIAN BUSINESS ENVIRONMENT IN THE CONTEXT OF TAX CHANGES IN THE PERIOD 2015 – 2018

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## **Abstract:**

*The purpose of the paper is to capture the evolution of the business environment as the Romanian tax legislation has undergone numerous changes in the last period. Therefore, we analyze the main fiscal regulations of the last 3 years (2015-2018), the effects on the demographics and structure of the business environment and the main difficulties, but also the challenges that the companies are currently facing. In this context we use a descriptive methodology, appealing to the current fiscal legislation in Romania and the most recent reports / documents and databases of the specialized bodies (Ministry of Finance, Institute of Statistics, Coface or Trade Register).*

**Keywords:** *fiscal regulations, firms, difficulties, challenges*

**Jel classification:** *H32, H 25*

## **Introduction**

In the period 2015-2018 in Romania there were about 560 tax changes regarding the way of taxing the profits of the companies that materialized in its orientation to a much greater extent towards the taxation of the revenues instead of the one of the profits, the quotas applied being reconsidered and now depending on the number of employees, and by replacing the corporate income tax with a specific tax for certain categories of activities. This change in the system of taxation of corporate earnings was achieved by massive expansion of the companies in the category of micro-enterprises, the ceiling of annual revenues up to which a company is included in this category being increased by more than 15 times in the period 2015-2018.

## **Tax changes regarding the direct taxation in the period 2015- 2018**

Legislative changes in the period 2015-2018 aimed at increasing of over 15 times the annual income ceiling to which a company is included in microenterprises category, namely increasing from 65 000 euro in 2015 to 100,000 euro in 2016, 500000 euro in 2017 and 1000000 euro in 2018.

As for the tax rates applied to the income of micro-enterprises, they have been reduced and differentiated according to the number of employees starting with the year 2016.

From the flat tax of 3% in 2015, in 2016, the rate of 3% was applied for companies without employees, 2% for companies with 1 employee and 1% for companies with at least 2 employees. In 2017, the number of tax rates was reduced to two: 1% for companies with employees and 3% for companies without employees.

Small companies have also the opportunity to opt for payment of income tax or profit tax, the capital conditions needed to exercise this option being significantly reduced, namely from the equivalent of 25000 euro in 2015 and 2016 to 45000 lei starting with the year 2017.

However, starting with January 1, 2017, companies with activities in tourism, restaurants and catering and paying the profit tax become liable to pay a specific tax, this tax having the characteristics of a flat tax.

In 2015, the Fiscal Code was rewritten. Law no. 227/2015 regarding the Fiscal Code aims to continue the measures to increase the efficiency of the fiscal system. Also, tax on dividends paid to

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Romanian legal persons had a reduction of the rate from 16% to 5% for dividends paid to Romanian legal persons.

Income tax on microenterprises:

- the increase of the ceiling of the classification in this system of taxation from 65000 euro to 100000 euro, as well as the introduction of a differentiated system of tax rates, between 1% - 3%. The tax rates on the income of micro-enterprises are: 1% for micro-enterprises that have more than 2 employees, including; 2% for micro-enterprises that have one employee; 3% for micro-enterprises that do not have employees.

- introducing a measure to support newly created micro-enterprises by introducing a tax rate of 1% in the first two years of existence of the legal person, conditioned by the hiring of an employee.

The fiscal measures regarding the introduction of differentiated tax rates for micro-enterprises between 1% and 3% of the total revenues, depending on the number of employees, compared to 3% previously, increasing the income ceiling up to which a company is considered micro-enterprise from the equivalent in lei of 65 000 euro to 100000 euro, have led to a budgetary impact estimated by the Ministry of Public Finance at about -300 million lei. Also, the exemption of the reinvested profit and the revision of the dividends income had a budgetary impact of - 56 million lei, respectively -57 million lei.

It was estimated that microenterprises - almost entirely with domestic capital, would be much more interested in fairness in business and in reducing the hidden economy. It was also estimated that about 80000 microenterprises, which in 2013 had neither turnover nor number of employees, will remain inactive. These measures aimed at increasing the number of jobs by about 101 thousand, increasing the profit / reduction of losses for microenterprises with more than 2 employees, increasing the income tax revenue and social contributions if some of these microenterprises will change their entrepreneurial approach and will hire one or two employees to benefit from the 1% tax.

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

The year 2017 was characterized by reduced receipts to the state budget, due to:

- Emergency Ordinance of January 6, 2017 on the modification of the micro-enterprises regime (increasing the threshold up to which a company is considered a micro-enterprise from EUR 100,000 in 2016 to EUR 500,000 starting with January 1, 2017), group of companies to which the tax rate per profit is significantly lower than other types of companies,

- wage increases throughout the economy, with a potential negative effect on corporate profit and, implicitly, a lower profit tax volume compared to 2016;

- Introducing, since January 1, 2017, the specific tax for companies in the tourism and food sectors that practically replaced the corporate tax (but with a reduced tax rate!).

In 2018, the main measures adopted were:

- Reducing the income tax rate from 16% to 10%;

- Reduction of the total share of compulsory social contributions, by a total of 2 percentage points, from 39.25% to 37.25%;

- Reducing the number of social contributions from 9 to 3, respectively the social insurance contribution (CAS), the social health insurance contribution (CASS) and the labor insurance contribution;

- Establishing for the employers the contribution of insurers for work at a rate of 2.25% for the income from wages and assimilated to wages;

- Transfer of the fiscal burden of the obligations regarding the compulsory social contributions due by the employer to the employee, in the case of income from wages and assimilated to wages;

- Introducing an improved VAT collection mechanism (split VAT);

- Reduction of the transfer rate to Pillar II to 3.75%, maintaining at the same absolute value of the transfer as compared to 2017.

According to the data in the table below, we observe that these fiscal measures adopted during the analyzed period have resulted in a reduction of the revenues to the consolidated budget (by types of income), as follows: the income from the profit tax reached 1.6% of GDP in 2018, from 2% of GDP in 2016 (but they have an upward trajectory in the coming years), the income tax revenues also decreased, reaching 2.4% of GDP in 2018, from 3.6% of GDP in 2016, VAT also registered a percentage decrease.

Table 1:

**Revenues of General Consolidated Budget – income types (% of GDP)**

	2016	2017	2018	2019	2020
Total, of which	29.4	29.4	31.1	33.5	32.2
Profit tax	2.0	1.7	1.6	1.7	1.6
Income tax	3.6	3.5	2.4	2.3	2.4
Property taxes	0.8	0.6	0.6	0.6	0.6
VTA	6.8	6.2	6.3	6.8	6.5

Source: Ministry of Public Finance, Fiscal-Budgetary Strategy 2019-2021

**Evolution of business environment in the period 2015- 2018**

According to the data of the National Trade Register Office, the following can be observed that the number of companies that interrupted their activity in 2018 exceeds the threshold of 140,000. At the same time, the number of newly registered SRL companies decreased in 2018 by 9%, in the context of high pressure on wage costs, labor migration, rising financing costs and the lack of fiscal predictability. This may indicate a deterioration of confidence in the prospects of the medium-long-term economy from current entrepreneurs, or those thinking of starting a company. Thus, at each new company registered in the previous year, there are almost 1.6 companies that have discontinued their activity.

**Table 2 Registrations vs Activity Interruptions Report**

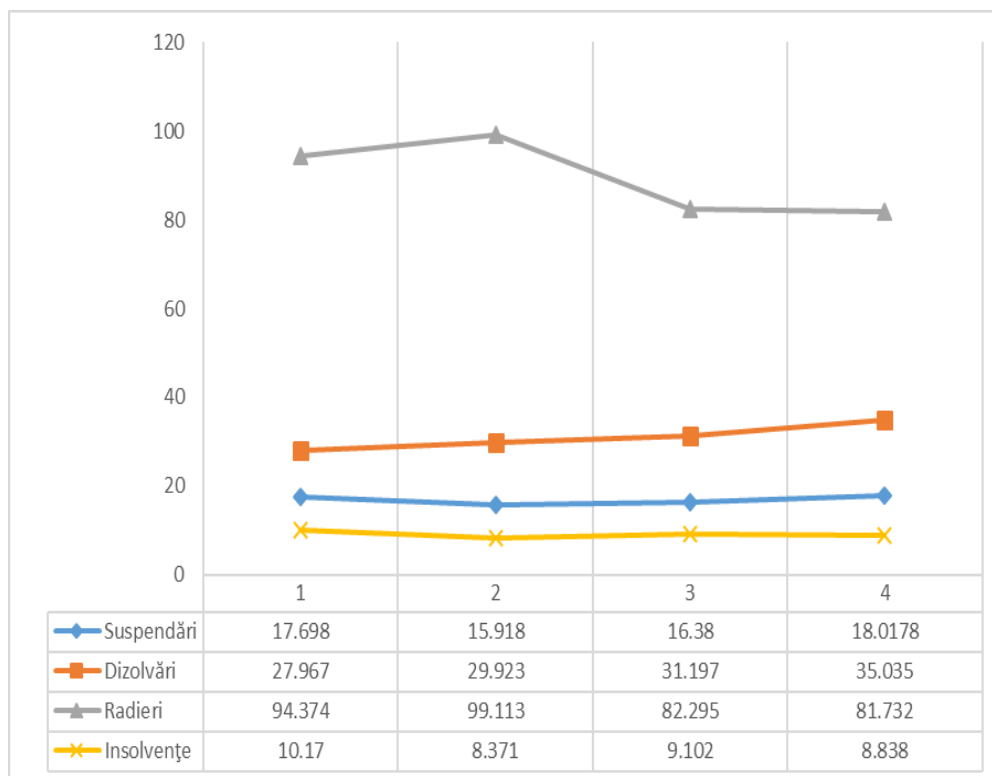
Interruption category	2015	2016	2017	2018
Suspensions	17.698	15.918	16.380	18.0178
Dissolutions	27.967	29.923	31.197	35.035
Cancellations	94.374	99.113	82.295	81.732
Insolvencies	10.170	8.371	9.102	8.838
<b>Total closures</b>	<b>150.209</b>	<b>153.325</b>	<b>138.974</b>	<b>143.783</b>
Total registrations	113.167	105.982	136.699	131.457
din care SRL	64.417	73.889	98.405	89.563
<b>Report OUT/ IN (SRL)</b>	<b>2.3</b>	<b>2.1</b>	<b>1.4</b>	<b>1.61</b>
<b>Survival rate</b>	<b>79%</b>	<b>82%</b>	<b>88%</b>	<b>95%</b>
<b>Consolidated net result</b>	<b>1%</b>	<b>-3%</b>	<b>-5%</b>	<b>-</b>

Source: Iancu Guda, Association of Financial and Banking Analysts of Romania, 2019, AAFBR Newsletter No.8

Regarding the interruptions (closures), we observe an increase in 2016 (the maximum reached), a reduction in 2017 and again an increase in 2018. This fact we consider is due to the economic context as a whole, and the fiscal measures taken in the respective period worsened the situation. As for registrations, they increased until 2017, and the following year they decreased.

The main factors that cause the decrease of the confidence level of the entrepreneurs, on the other hand, are:

- Increased expenditure (especially on wages, utilities and fuel);
- Increased interest expenses and repayment of bank loans;
- Fiscal unpredictability (uncertainty regarding new tax regulations);
- The Romanian underground economy (estimated by the European Commission at almost 32% of GDP, the highest level in the EU after Bulgaria);
- Difficulty finding a workforce at a salary that reflects real productivity.



**Figure 1. Evolution of interruption in the period 2015- 2018**

Source: figure based on data from Table no.2

The future perspectives are pessimistic, because the vulnerability of the active business environment in Romania has increased in the last decade due to the following factors: modest long-term investments, decapitalization of companies, loss of short-term financial independence due to negative working capital, systemic risk increase due to extending the billing deadline to historic highs, oversizing stocks, increasing pressures on corporate profitability and fueling an inflationary spiral process due to rising costs, rising wages over productivity, polarizing revenues and liquidity at large companies in the context of sub-bedding , tensing the labor market due to the depopularization of Romania and the underdevelopment of the national road transport network.

### **Barriers to business activity**

The main factors that cause challenges and risks for the business environment are;

- The level of taxes and dues,
- Frequent and unpredictable changes in policies, laws, regulations of an economic nature
- Macro-instability

The causes that led to a high difference in the number of registrations in the first 6 months of 2018 compared to 2017, were various, the most important being the marked instability of the tax legislation registered in the first quarter of 2018, as well as the huge volume of normative acts adopted (in the first 6 months of 2018, the legislative framework was majorly modified, being adopted 1210 normative acts, over 45% of the laws and ordinances adopted affecting directly and significantly the companies, including SMEs - tax legislation, declarations and mandatory contributions, etc.).

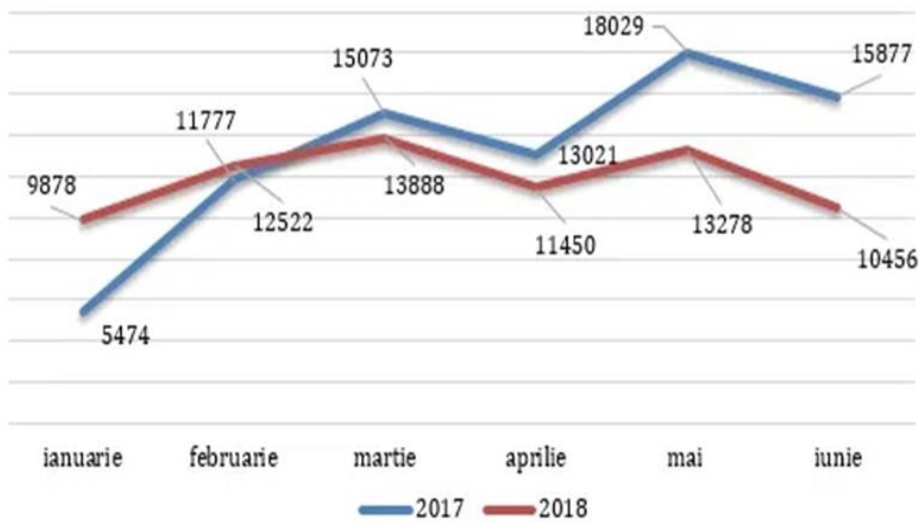
The volume of amendments to the Fiscal Code of the first quarter of 2018 was 173% higher than in the first quarter of 2017 (69 articles modified / completed in the first quarter of 2017 vs. 120 articles modified / completed in the first quarter of 2018), in the conditions in which last year it was registered a record of tax legislative changes (290 articles of the Fiscal Code were modified / completed). In the first 90 days of 2018, the business environment was obliged to implement 217 new regulations amending / completing Law no. 227/2015 regarding the Fiscal Code, 97 even from the first day of the year and another 120 adopted at very short distances, to which were added important changes of the Fiscal Procedure Code and the legislation on compulsory contributions.

Changes in tax legislation have generated multiple negative effects on SMEs:

- Increased bureaucracy for all taxpayers and employers;
- Significant effort to implement legislative reforms;
- Increased personnel costs;
- Significant implementation difficulties due to the very short implementation time;
- Increasing the administrative expenses, regarding the updating of computer programs;
- Issues of ensuring competitiveness and the development of contracts for export.

The last decade finds the Romanian business environment somehow "poor" from the point of view of the number of businesses, polarization being the word that characterizes it, large companies providing 86% of revenues while microenterprises realize about 14% of total revenues. Also, of the total number of companies registered in Romania (690000), approximately 190000 companies have no activity at all. Of the remaining approximately 500000 active companies, only about 27700 companies have an annual turnover of more than 1 million euros, respectively 4% of the total, while 96% of these are micro-enterprises.

Although on many indicators small companies and large companies have had similar starting points 10 years ago, the last decade has sifted in favor of caliber players. The latter concentrate not only market shares, but also profits, being more robust in terms of the degree of indebtedness, the efficiency of the use of assets and the relationships with trading partners.



**Figure 2. Number of new- created firms 2018 vs. 2017 (first semester)**

*Source: data collected from [www.onrc.ro](http://www.onrc.ro)*

The effects of fiscal instability highlighted in 2018, according to the SME Council's balance sheet (Figure no.2):

- Companies with new foreign capital established between 01.01.2018 - 31.10.2018 (4718 companies) are less with 177 companies compared with the period 01.01.2017 - 31.10.2017 (4895 companies);

- The total number of registrations between 01.01.2018 - 31.10.2018 decreased by 8,457 registrations, compared with the similar number from 01.01.2017 - 31.10.2017 (113144 vs. 121601)

Between 01.01.2018 - 31.10.2018 the number of suspensions, dissolutions, insolvencies among companies with foreign participation in the capital were higher than those from the period 01.01.2017 - 31.10.2017;

Between 01.01.2018 - 31.10.2018, the number of suspensions increased by 13.32% (15014 suspensions, compared with 13249 in the period 01.01.2017 - 31.10.2017);

Between 01.01.2018 - 31.10.2018 the number of dissolutions increased by 20.71% (29278 dissolutions, compared to 24254 during the period 01.01.2017 - 31.10.2017);

Between 01.01.2018 - 31.10.2018 the number of insolvencies increased by 28.07% (1492 insolvencies, compared with 1165 during the period 01.01.2017 - 31.10.2017).

## Conclusions

Trust in the tax system is an essential condition for investors, predictability being one of the most important factors influencing investment decisions, with direct effects on the growth of the number of SMEs and jobs, increasing the potential and performance of companies, intensifying the innovation of products and services, technologies, systems and methods of management, marketing, financial and GDP revenues.

The main factors that cause challenges and risks for the business environment are the level of taxes and dues, frequent and unpredictable changes in policies, laws, regulations of an economic nature and macro-instability. Also, changes in tax legislation have generated multiple negative effects on SMEs, such as: increased bureaucracy for all taxpayers and employers; significant effort to implement legislative reforms; increased personnel costs; significant implementation difficulties due to the very short implementation time; increasing the administrative expenses, regarding the updating of computer programs; issues of ensuring competitiveness and the development of contracts for export.

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