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# THE UNSEEN BURDEN OF THE ROMANIAN TAX SYSTEM

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**Abstract:**

*Fiscality is an essential element to corporate performance, which is why the costs generated by the Romanian tax system are a highly important topic. In the context of more and more frequent legislative changes, and due to the lack of consistency when applying various regulations, the aim of the present paper is to emphasize the hidden costs generated by the tax system.*

**Key words:** *hidden fiscal costs, tax compliance costs, fiscality, legislative unpredictability*

## 1. Introduction

Tax burdens are known by considering their various ways of manifestation, calculation and appreciation: in a national economy, upon individual taxpayers, or in companies. The government's wide intervention over the last two centuries in the economy and the society itself has generated an increase in tax burdens. This statement is supported by the similar change in financial resources, tax burden and public expenses, namely an increase lately. Fiscality (Pătroi, 2006, p. 68) is a "confinement element of any taxpayer irrespective of their fiscal civic attitudes which become ever more uncomfortable according to higher tax burdens or according to how their management proves inadequate to the clearly stated intentions of public powers". The increase in the percentage share shows the decrease in the available income of a taxpayer whereas its reduction means keeping their revenues in as high an amount as possible.

## 2. Hidden Fiscal Costs Generated by the Romanian Tax System

Besides the taxes, fees and contributions paid to the State, an enterprise also bears other costs which can be associated to a fiscal cost as they are generated by the fiscal system. They are called hidden costs because, unlike visible costs, they cannot be quantified precisely.

In this context, Sterpan and Busuioc (2011) stated: “The State’s fiscal costs either expressed as the sum of taxes and fees, or as the ratio between public expenses and the GDP, are only the top of an iceberg when it comes to the State’s costs. Most of the state cost significantly exceeds the value of transparent contributions. The hidden burden of the State includes besides taxes and fees, the operating cost of administrative, legislative, judicial bodies and the cost of their effects”.

The category of hidden costs borne by taxpayers as they have been shown in specialty literature includes:

- administrative costs which include operating expenses of the entire tax system concerning the management and collection of taxes;
- compliance costs which include costs borne by taxpayers in order to comply with legal regulations regarding fiscal obligations.
- psychological costs generated by conditions of stress, anxiety and frustration occurring as a consequence of how the fiscal system in Romania works.

In our country, hidden fiscal costs are generated by several factors as they are shown in the following.

Firstly, a fiscal cost must be regarded from the perspective of payment terms and recovery time for fiscal receivables or losses. Thus, payments that are actually taxes, obligations and fees are made on certain dates set out by the State’s bodies. Failure to pay them by the due date brings about taxpayers’ obligation to pay delay penalties. Interests, delay penalties or delay additions due to the failure of paying taxes are (Ordinance no. 92/2003 regarding the Tax Code):

- 0.04% penalty interest per day. This interest is applied starting on the day following the due date until the date of debt repayment;
- 5% delayed payment penalty for failure to pay fiscal duties on legally set out date for a period of up to 60 days and 15% delayed payment penalty for a period exceeding 60 days.

Furthermore, in case local budget duties are not paid on their due date, 2% late payment additions are charged from the amount of initial fiscal obligations and they are calculated starting on the first day immediately following due date.

Interests, penalties and additions that a taxpayer in Romania has to bear are a significant percentage share of their total fiscal cost especially if one considers that there are rare circumstances when a taxpayer does not face penalties or additions for their failure to pay their fiscal duties within the terms stipulated by the law.

As far as additions, penalties and interests are concerned, legislative changes must not be neglected either, as they have caused confusions when applying the law regulating them. Thus, since 2003, legal regulations have been using the terms “delay additions” along with “delay interests” as follows:

- until late 2002, the term “addition’ was used;
- during January 2003 – July 2005, the term “interests” was used;
- during July 2005 – June 2010, the term “additions” was used;
- since July 2010, the term “interests” has been used;

- since September 2011, more precisely since January 2006, they have started to reuse the terms “0.05% penalty component of delay additions” and “0.05% interest component of delay additions”.

This example emphasizes another hidden fiscal cost that a taxpayer must bear, namely the cost generated by the legislative system’ unpredictability and lack of coherence.

In terms of costs generated by the tax system, Sterpan and Busuioc (2011) stated the following: “When one measures the State’s total cost, one can firstly think of the fact that even a small business needs the complex endeavours of an accountant or a legal adviser to mediate the difficult relationship with the State. Fiscality applies to company revenues only after these services’ costs needed to develop activities have been paid. The cost of an accountant’s salary is mostly imposed to an entrepreneur by the State even if in a concealed manner”.

Another example of legislative unpredictability is the taxation system for small enterprises which has undergone various changes over the years, as follows:

- for the year 2009, a small enterprise paid a 3% revenue tax and taxpayers were able to choose such a taxation system;
- in the early 2010, the 3% revenue tax was dropped in favour of a 16% corporate tax;
- since 1 January 2011, they have started to resort to the choice of the 3% revenue tax again;
- the year 2013 has brought about major changes as far as a small enterprise is concerned by presenting the duty to pay a 3% income tax for all taxpayers whose total incomes are not more 65,000 Euro, as the condition regarding the number of employees has been revoked.

Another legislative unpredictability of the Romanian fiscal system is related to the change in benefit obligations. In this context, (Marsu, 2011) stated: “It is known that the benefit obligation level owed by an employee to the Second Category of Pensions (mandatory private pensions) was set to reach 3% in 2010 but only since 1 January 2011, the level has reached this target. The previously set out pattern has not been observed and additionally the entire Second Category obligation was threatened to be renationalized in the spring of 2010”.

In the opinion of Valentina Sgarbura (quoted by Dumitrescu, 2012, p. 62), the Managing Partner at Advise Expert Accounting, the most painful legislative anomaly is Article 4 of the Fiscal Code. “The present Code is amended and added to only by a law which is usually promoted six months before its coming into force”.

“Usually” does nothing but puzzle the entire legislative system dedicated to the business environment so that speaking about predictability in the Romanian fiscal legislation is becoming a utopia”, Sgarbura said (quoted by Dumitrescu, 2012, p. 63).

“In my capacity as an accounting specialist, I find it almost impossible to practise my profession in the best conditions, to work with budgets, prognoses and estimations. This aspect does nothing but keep foreign investors at a distance because of the lack in fiscal consistency. A direct consequence of the word “usually” has been

the rapid change of the VAT rate from 19% to 24%, with all its negative implications”, stated Sgarbura (quoted by Dumitrescu, 2012, p. 63).

### **3. Ways to Quantify Hidden Fiscal Costs**

A fiscal cost may also be regarded as an effective operational reference of a taxpayer in relation with the system of taxes and fees. Thus, in specialty literature, certain indicators are used which provide a suggestive view of a fiscal cost according to the efforts of a taxpayer to comply with legislation and fiscal management requirements.

In the annual report of Doing Business prepared by the World Bank along with International Finance Corporation (IFC), three indicators are used regarding the fiscal cost a company bears, namely:

1. The first indicator is the number of hours a taxpayer spends annually to pay their fiscal duties. The time devoted by a company to comply with the formalities ensuing from its relationship with fiscal management is influenced by numerous factors: the complexity of the fiscal system and its bureaucracy, the system's transparency and the clearness of norms and procedures, fiscal procedures' level of computerization etc.

In order to calculate this indicator, the number of hours needed by a taxpayer is taken into account in order to:

- be informed on the calculation way of a tax;
- fill in tax forms;
- pay the taxes owed to the State;
- to bookkeep taxes.

The indicator is calculated taking account of tax types, as follows:

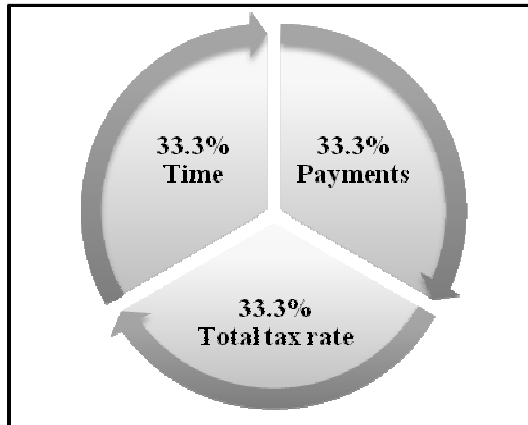
- corporate tax;
  - taxes on consumption;
  - taxes and fees associated with salaries.
2. Another relevant indicator to the complexity of fiscal system is rendered by the number of taxes, fees and obligations owed by an average taxpayer.
  3. The third indicator used in Doing Business reports is the total taxation rate.

The rank of our country as compared with other countries in question is determined as an average of the three indicators as shown in the Figure 1.

The Doing Business Report mainly pursues to make up a ranking for 183 countries regarding the easiness of doing business. The report presents the legislative changes in the business environment to make loans and to set up companies up to the regulation of bankruptcy and the protection of investors.

The total ranking referring to business friendliness relies on ten indicators: registering some business; getting a building permit; easiness of a company when getting connected to an electricity source; registering the property; making loans; protecting investors; paying taxes; crossborder trade; executing contracts and settling matters related to insolvency.

Figure 1. Methodology for calculating rank



In the Doing Business 2012 Report, Romania ranks the 154th of 183 countries in terms of the way to carry out payments of taxes, fees and obligations to the State.

According to the ranking made by Doing Business 2012, Romania performs payments of 113 taxes annually and the time needed to prepare and make these payments is 222 hours a year. The total taxation rate in our country is 44.4%.

The value of the three indicators as they have been calculated in Doing Business 2012 Report is the following:

Table 1. Indicators paying taxes

Country	Payments (number per year)	Time (hours per year)	Total tax rate (% profit)	Rank
Bulgaria	17	500	28.1%	69
Moldova	48	228	31.3%	83
Hungary	13	277	52.4%	117
Czech Republic	8	557	49.1%	119
Poland	29	296	43.6%	128
Slovak Republic	31	231	48.8%	130
<b>Romania</b>	<b>113</b>	<b>222</b>	<b>44.4%</b>	<b>154</b>
Ukraine	135	657	57.1%	181

Source: Created by author based on data from Doing Business 2012

In conclusion, at world level, as compared to Romania, only Ukraine requires the payment of a larger number of taxes, namely 135. Although Bulgaria pays only 17 taxes, it needs 500 hours to carry out their payment.

As far as the share of each tax type in the total taxation rate is concerned, as well as in terms of the three indicators' value, in relation with the situations in countries

in Eastern Europe, Central Asia, and the member states of the Organization for Economic Cooperation and Development (OECD), things are the following:

**Table 2. Summary of tax rates and administrative burden in Romania**

Indicator	Romania	Europa de Est & Asia Centrală	OECD
Payments (number per year)	113	37	13
Time (hours per year)	222	302	186
Profit tax (%)	10.4	9.3	15.4
Labor tax and contributions (%)	31.8	21.7	24.0
Other taxes (%)	2.2	9.5	3.2
Total tax rate (% profit)	44.4	40.4	42.7

Source: Doing Business Report 2012

According to the data in the above table, the highest percentage of the total taxation rate is held by payments related to work force taxes and obligations. They have a higher share in Romania (31.8%) as compared with the share they have in other regions examined, namely Eastern Europe & Central Asia (21.7%) and OECD member states (24.0%).

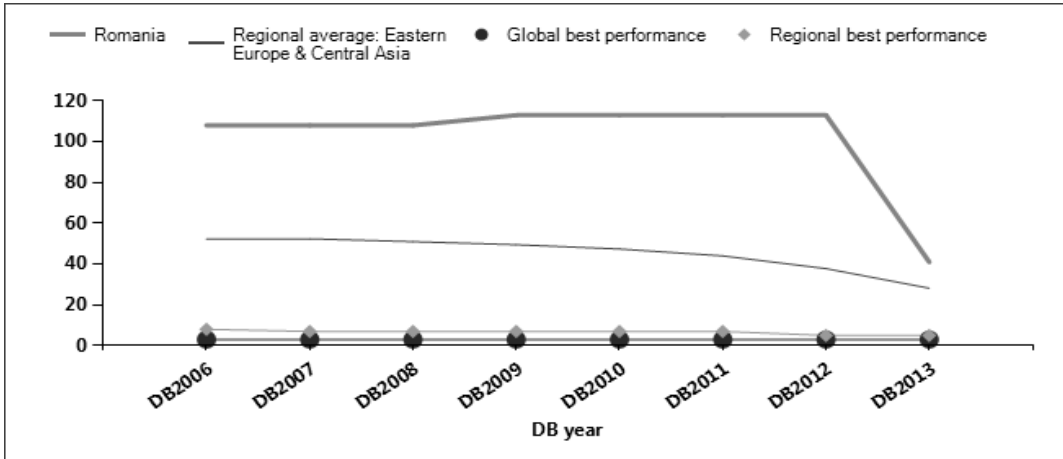
In terms of the progress of the three indicators in Romania, the situation is as follows:

**Table 3. The ease of paying taxes in Romania over time By Doing Business report year**

Indicator	2006	2007	2008	2009	2010	2011	2012	2013
Rank	..	..	..	..	..	..	157	136
Payments (number per year)	108	108	108	113	113	113	113	41
Time (hours per year)	190	193	202	202	202	222	222	216
Total tax rate (% profit)	57.2	49.5	46.9	46.8	46.4	44.9	44.4	44.2

Source: Doing Business Report 2013

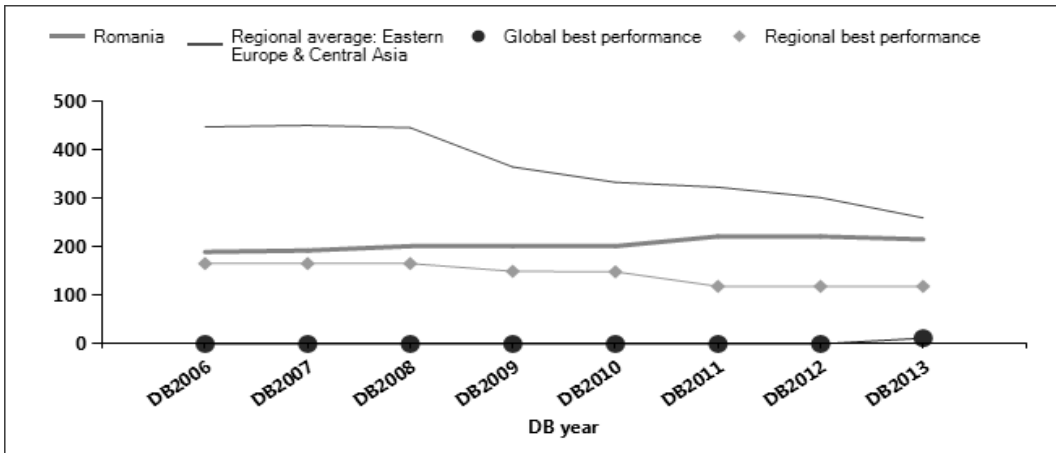
Figure 2. Payments (number per year)



Source: Doing Business Report 2013

The value of Romania's payment indicator has considerably increased. Whereas in the report of 2012 its value was 113, in the report of 2013, the indicator value is 41. In connection with the countries examined, the payment indicator of our country is close to the regional average for Eastern Europe and Central Asia.

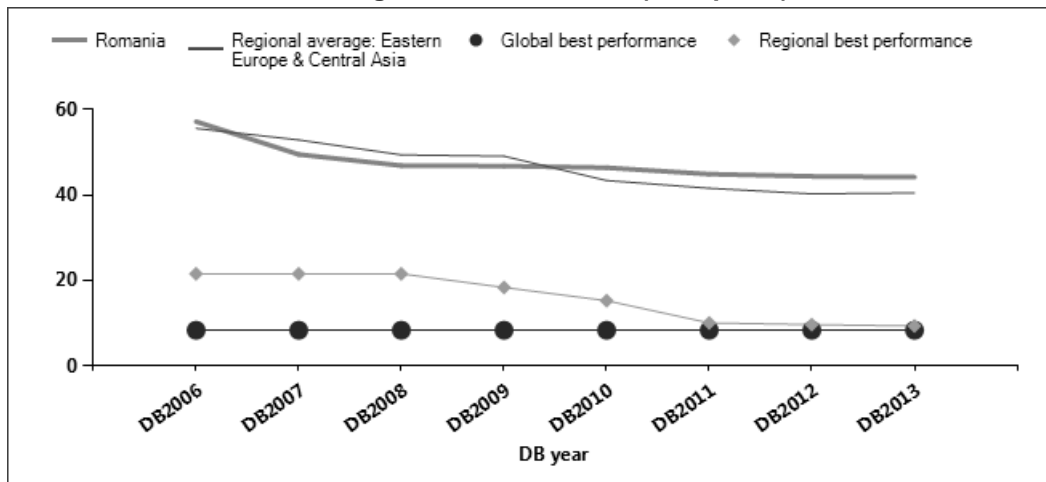
Figure 3. Time (hours per year)



Source: Doing Business Report 2013

As far as the time indicator is concerned –the number of hours spent by a taxpayer annually while paying their fiscal duties – during 2006 – 2013, its value in Romania did not have major changes, having an average level of 206 hours/year. As compared with the countries examined, the indicator has close values to the best value at regional level.

**Figure 4. Total tax rate (% of profit)**



Source: Doing Business Report 2013

The total taxation rate in Romania during 2006 – 2013 was slightly descending. It had a relatively close value to the regional average in Eastern Europe and Central Asia, instead its pretty high value compared to the best value at regional and world levels was obvious.

In terms of the way the payments of taxes, fees and obligations are made to the State, Romania has gained 21 ranking positions as compared with last year, currently ranking the 136th.

#### **4. Conclusions**

In conclusion, whether it is about our country or any other, fiscality generates various hidden costs along with the visible ones. They are directly proportional to the fiscal system complexity and to its unpredictability degree associated with numerous legislative changes.

Fiscal unpredictability discourages foreign investors that want to invest in Romania and those who already have might as well leave, because fiscal changes that happen over night wreck their business plans. Our country is an attractive market to foreign investors from the perspective of low work force costs, but its fiscal unpredictability makes some investors turn their attention to other countries.

Therefore, besides the high tax burden generated by the visible costs of fiscality, a major issue of the Romanian fiscal system is, as shown above, the complexity and uncertainty of fiscal policies. For long-term outcomes, it is necessary both to reduce the burden of taxes, fees and obligations to the State and a simplified, more stable fiscal system.



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