

ARGUMENTS AGAINST MINIMUM TAX

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Abstract: This article seeks to debate from a critical perspective the opportunity and legality of introducing the minimum tax system introduced in Romania by the Emergency Ordinance on the budget rectification for the year 2009 and the regulation of some financial and fiscal measures.

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Introduction

Ever since 1776, Adam Smith stated in his famous work “*that too high tax rates destroy the tax base*”. He stated for the first time the principles of taxation, of which, in support of what was said, we remember the first of them: “*The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*” [1].

In the 80's of last century, the American economist Arthur Betz Laffer popularized the famous curve that bears his name (Laffer curve)¹, by which, essentially, showed the effects of increasing the tax rates as it follows: when tax rates increase, the tax revenues will increase to a point considered the maximum tax rate acceptability. When this tax rate increases above the optimal tax rate, the tax revenues will decrease as taxpayers will give up the taxable activities that generate the tax base. Laffer's ideas were used by President Reagen in rehabilitating U.S. economy.

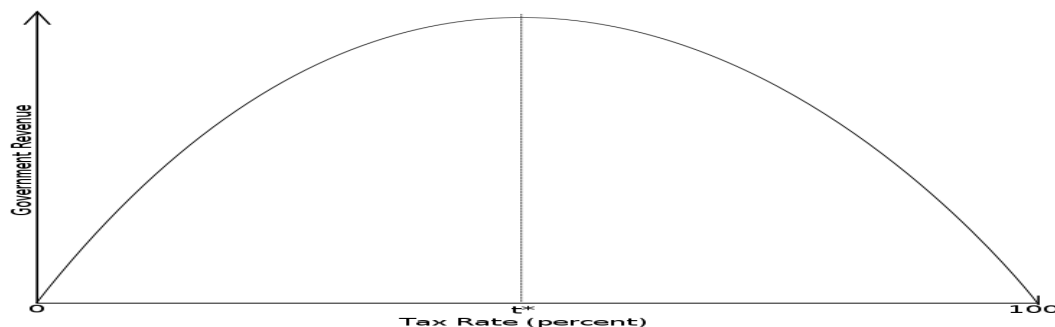


Fig. 1. Laffer curve

¹ The *Laffer curve* is an economic concept used to illustrate the theory that increases in the rate of taxation do not necessarily increase tax revenue. The basic assumption is that both a 0% income tax rate and a 100% tax rate will generate no revenue. An optimal tax rate is therefore assumed to lie somewhere in between. Increasing taxes beyond this optimal point (the peak of the Laffer curve) is assumed to decrease tax revenue. The Laffer curve is central to supply side economics, as it provides an argument for why lowering taxation may actually increase tax revenues.

Also, since John Maynard Keynes, economic theory recommends as being useful for economic crisis situations the following measures in the budgetary and fiscal field [2]:

- increasing budgetary expenditures and/or
- lower taxes.

Following the deep and complex economic crisis that has seized Europe, the report called „Credit Crunch – The EU at Work” suggested early since October 28, 2008, that “amid fears of a global recession, the Commission is pressing for rapid adoption of measures proposed in June to help small businesses, which create most new jobs in the EU”.²

Among these measures it is also referred to "lower taxes" with a positive impact upon maintaining and creating jobs and upon purchasing power, especially for those with low incomes.

None of these arguments were taken into account when in Romania it was decided³, by upgrading the system of taxation of incomes and profits of economic agents, introducing the so-called flat-rate - lump tax (minimum tax), which considered implicitly creates a premiere in the local tax landscape: tax loss.

Following our approach we will try to explain the negative attitude towards the opportunity, manner and need to introduce such a tax system, by presenting also other arguments:

- objections of legislative character, national and European;
- objections of economic character, caused by the negative economic impact of the measure;
- objections of opportunity, based on the trends in other European countries.

1. Objections of legislative character

A. The ordinance of introducing the lump tax violates the principles of the Tax Code and the rules of entry into force of any amendments to it.

Thus, it is violated the principle provisioned by the article 3 letter d) of the Tax Code, on the taxation efficiency.

Art. 3. Principles of taxation

„Taxes and duties under this code are based on the following principles: (...)

***d) taxation efficiency by providing long-term stability** of the provisions of the Tax Code, so that these provisions do not lead to unfavourable retroactive effects to legal and natural persons, in relation to the taxation in force upon the enactment date by them of some major investment decisions. "*

Moreover, the immediate implementation of any amendments and not starting with the next fiscal year is expressly prohibited by the Law 571/2003 on the Tax Code.

Art. 4. A. The present code is amended and supplemented only by law, usually promoted by 6 months before its entry into force. (2) Any amendment or supplement to this Code shall take effect from the first day of the year following that in which it was enacted by law.“

It should be noted also the obligation to amend the Tax Code only by law. Or, paraphrasing a famous saying, ordinance is not like law.

B. The ordinance violates the Treaty on European Union, according to the jurisprudence of the European Court of Justice

- *Discrimination does not only arise from the different treatment based on nationality, but also from the similar treatment for the taxpayers in different situations.*

The case of the European Court of Justice C-76/90 Manfred Sager vs. Dennemeyer 1991 - ECR I - 4221, paragraph 12, states: "Article 49 of the Treaty requires not only the elimination of discrimination based on nationality of a person providing services, but also the elimination of any obstacles to the internal market (even if it is applied the same treatment both

² http://ec.europa.eu/commission_barroso/president/focus/credit_crunch/index_en.htm

³ Emergency Ordinance no. 34/11.04.2009 on the budgetary rectification for the year 2009 and the regulation of some financial and fiscal measures, published in the Official Gazzette no. 249/14.04.2009.

to resident providers and suppliers from other Member States), where these lead to trouble the activities of the service provider established in another Member State ... "It is *discriminatory a similar treatment for the taxpayers in different situations*.

Example: Making a mathematical calculation based on the conditions of the law, introducing a minimum income tax is translated into the fact that the legislator taxes identically two companies recording turnovers (sales) of 1,300,000 lei (about 320,000 euros) of which one is recording losses, and the other, to a net profit margin of 4135%, profits of 53,750 lei (about 12,500 euros)

- *Anti-abuse measures provided by the Ordinance are restrictions on fundamental freedoms if they are not justified.*

The introduction of the minimum income tax represents anti-evasion or anti-abuse measures. Such measures are restrictions on the freedoms of the internal market and are prohibited by the EU Treaty unless they are justified: According to the decision on Halifax Case of the European Court of Justice (C-255/02), "anti-abuse measures are not justified if the economic activity carried out may explain reasons other than simply obtaining tax benefits." Thus, the measures introduced by the Government's Emergency Ordinance are not justified for the companies recording actual losses of the economic activity, caused by the crisis, and not by the obvious intention to avoid taxation.

- *The provisions of the Ordinance are excessive*

Any national legislation which may prevent the application of fundamental freedoms introduced by the EU Treaty (**The Case of the European Court of Justice Gebhard v Consiglio dell'Ordine degli Avvocati, Case C-55/94**) must not exceed what is necessary to achieve the goal. The taxation measure of income tax for the companies that recorded losses goes further than necessary to achieve the goal of halting the abusive practices used to avoid paying taxes and duties. IRS has, also at this time, instruments available for this purpose (National Agency for Tax Administration opportunity to reconsider the transactions concluded between affiliated companies in order to apply a higher tax, the provisions of treaties to avoid double taxation, tax evasion law, the powers of the authorities in some cases to determine the tax base by estimation, and so on).

2. Objections of economic character

Minimum tax:

- discourages new investments – during the start-up phase the companies have high costs and record losses, but they pay this tax;
- discourages large investments - the purchase of expensive technological equipments, depreciated by accelerated depreciation (the method guaranteed by the Tax Code) can generate tax losses; the companies that make such investments still pay this minimum income tax;
- affects the entire services sector, considered strategic for the emerging economies, which share in the GDP is essential to increase competitiveness;
- affects retailers - in conditions of economic crisis, retailers are forced to apply significant discounts and to increase the advertising and marketing expenditures, leading to record real losses;
- under privileges food industry which is extremely exposed to the obligation to pay a disproportionate tax because food production which is dependent on agriculture records large actual flows from one year to another;
- affects real estate transactions made at a loss during this period of assets depreciation because they are penalized with a surcharge;
- encourages tax evasion - for instance, the use of schemes to avoid the reclassification of incomes under some categories taxed more favorably (for instance transforming a large part of companies affected by the introduction of flat tax in freelancers, who are not affected in terms of tax burdens by the introduction of flat tax.

3. Objections of opportunity

This type of tax is currently in the process of elimination in other EU countries.

Other countries have introduced taxes similar to minimum income tax (France, Hungary) in periods of economic boom, when suspicion regarding taxpayers attempt to artificially increase their costs may be justified to some extent; but in times of crisis, this suspicion has no basis, consequently, countries like France and Hungary are working to abolish this tax.

Thus, in France, the companies with a turnover below EUR 1.5 million are exempted from paying the annual flat-rate tax. In 2010 there will be exempted the companies with a turnover below EUR 15 million, going that in 2011 this tax to be completely eliminated.

Hungary applied an alternative minimum tax⁴ (flat tax) of 4% which involves comparing the tax base, determined according to the general rule for taxation of companies, with a minimum taxable base consisting of the difference between total incomes and certain allowed deductions (for instance, the cost of raw materials and materials) to which it is applied a rate of 2%.

Hungary has already decided to eliminate this tax system as representing an anti-crisis measure.

Conclusions

The substantiation reference⁵ of the discussed normative document highlights the following: "Of the analyses conducted by the Ministry of Public Finance it results that, in the year 2007, of the 617,525 corporate taxpayers, 2000 of them provide over 85% of public revenues. The number of companies that reported losses in the year 2007 was of 242,106 (39.2% of the total registered companies), given that the turnover of these enterprises amounted to 134 billion lei. Given the high volatility of the tax base for income tax there are required a series of limitation measures, to ensure an equitable and fair tax system for everyone. The Government should not encourage the "free rider" behaviour (getting the benefit without paying the price of that benefit). In this regard, it is intended to replace the volatile tax base with a certain tax base to ensure an equitable and fair treatment for all.

Analyzing the text carefully, one can easily determine how the Government concludes that all 242,106 economic agents are thieves, depriving the Government of the income tax. Therefore, the principle of innocence and good faith does not exist.

In any legal system "the defendant" needn't prove its innocence but the prosecutor must prove its guilt (in this case, tax evasion). For this there are the specialized agencies of the Government (National Agency for Tax Administration).

Otherwise, the Government, by an act of total contempt for those with entrepreneurial spirit, transfers one of its obligations (that of ensuring the observance of legality) on the shoulders of citizens, recognizing the inability to manage the phenomenon of tax evasion.

Still, following the logic of the Government we can only ask ourselves which is the difference between an economic agent who fails to make profit and the Government which administrates businesses from which the budget is systematically emptied? Considering this situation, becoming more and more common, shouldn't the Government compensate its citizens!?

REFERENCES

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⁵ http://www.gov.ro/nota-de-fundamentare-oug-nr-34-11-04-2009_11a105331.html

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