

BUSINESS ENVIRONMENT AND NATIONAL TAX

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1. Introduction

Fiscal policy is a factor of particular importance for the economic, politic and social life of a country, and its influence and effects are visible to everyone, even to people with no economic knowledge or direct implication in the economic system.

In Romania, fiscality has been one of the domains that has undergone the most significant transformations in recent years and, unfortunately, those transformations took place either too slow or too fast, the financial environment remaining thus within the tax payer's conscience as an instability factor for the development of the local economical system.

The remarkable progress of the tax law that started in 2004 by merging the tax provisions into a single Code¹ has sometimes been overshadowed by the inability of the state to meet the basic principles assumed.

The efficiency and the certainty of imposition, the stability and the predictability of the tax system are essential principles for a viable economy. Unfortunately, at the present, precisely these principles are flagrantly violated when the economic Romanian strategy is being developed.

The business environment is aware of the legislative progress, like the

harmonization with the European regulatory framework or the flat tax introduction. However, poor administrative capacity remains the weak link of the Romanian tax system.

2. The Radiography of the Local Business Requirements

Several recent studies clearly illustrate the requirements of the business environment in our country, claims that, from our point of view, are both decent and realistic.

Thus, the main conclusions drawn from the Deloitte Tax² study in 2009 are:

1. The business environment stresses the need for authorities to pursue a medium and long term financial strategy and to focus their efforts to reduce the frequency of legislative changes (34%).

¹ Law no. 571/22 December 2003 concerning the tax Code came into force starting with 01 January 2004.

² Deloitte Tax realized the study "Romanian fiscality – The radiography of an incomplete reform", gathering the opinions of the financial managers or tax department coordinators within the most important companies in Romania.

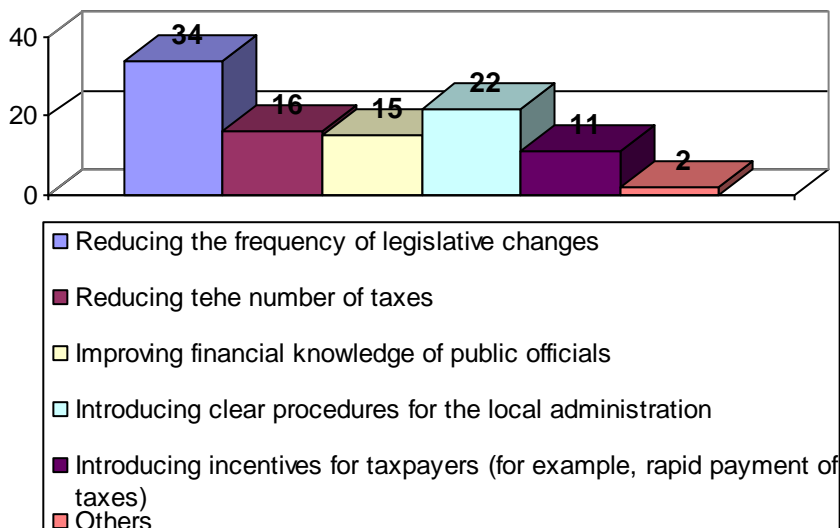


Fig. no.1 – Financial priorities of the business environment

The Romanian entrepreneurs claim that the discordance of the administrative procedures attracts in return additional costs for companies and delays in carrying out their activities. Therefore, they consider it appropriate to introduce clear tax administration procedures (22%).

Also, most respondents agreed that the legislation covering the various taxes is complicated, and that it often creates conflict between present cases and similar cases from the past.

II. The entrepreneurs surveyed also drafted a ranking of specific tax measures, which can stimulate the business environment and maintain strategic development objectives, three of these measures leading within the contributors' agenda.

In a context where taxpayers have less and less access to investment crediting, the first choice among businessmen (24% of respondents) is the exempt from income tax for reinvested profits. However, such a measure would really be beneficial in terms of a real exempt accessible to all taxpayers, regardless of their size or scope of work.

Currently, the legislative proposal to introduce the above mentioned measure does not meet these criteria, resulting only in postponing the moment of taxation.

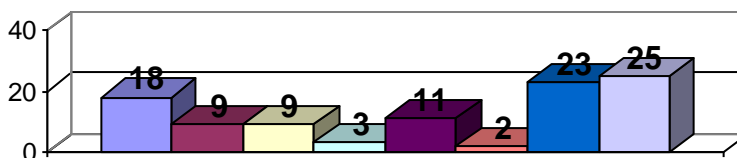
Placing a limit for the social contributions is an important measure for 23% of the companies surveyed. In the context where the current level of social contributions represents one of the most important costs for companies, their cap would encourage attracting qualified labor and employee retention, while increasing competitiveness in Europe.

The third measure that respondents consider as being extremely important is the mechanism concerning the VAT refund; 18% of the respondents say that the implementation of a clear and rapid repayment would unlock the present system crisis in this area.

The Foreign Investors Council created in 1997 counts the largest foreign investors in Romania, with 110 member companies. It summarizes, perhaps in the most suggestive manner, which the main business requirements are:

- Maintaining the flat tax and the VAT level;
- Fiscal Stability;

- Improve the efficiency of tax collection;
- Reducing tax evasion;
- A coherent fiscal strategy.



- Clear and quick WATT refunds
- Deferred payment of customs tax
- Implementation of VAT groups (a group of private entities regarded as a single person in terms of VAT)
- The reintroduction of the reverse charge for construction
- Introduce tax groups for income tax (consolidation of the group's profit and loss)
- Change of the tax laws related to restructuring (relaxing the conditions to be met to ensure fiscal neutrality)
- Placing a limit for the social contributions paid
- Exemption of tax for the reinvested profit

Fig. no.2 – The main tax measures to be implemented, according to investors

Another study published in March 2010, conducted by Leitner Leitner³ on a sample of 50 investors from Germany, Switzerland and Austria, concerning the way they perceive the tax environment in Romania, shows a worsening of the Romanian fiscal climate.

Thus, 64% of the respondents believe that the Romanian tax environment has a high instability degree, which often forces them to revise their business plans. This is, in fact, the most significant complaint of the investors surveyed. It is difficult for a company to invest if it does not know the state's medium-term strategy. Business plans are usually made for more than

one year, but given the present context, where tax laws are changed and published before entering into force, creating a business plan is difficult from the very beginning.

Foreign investors also believe that tax provisions are ambiguous. Survey participants say that the laws and provisions published in the Official Gazette are difficult to understand, implement and follow and only 39% of them use the Official Gazette as a source of information on the tax system, while 25% are turning to tax consultants and 14% use media channels (television, radio and magazines).

Respondents are also not satisfied by the tax authorities, whom they consider as being bureaucratic, rigid and without sufficient expertise, according to the survey. However, only 25% of the respondents say that tax authorities are cooperating, while 27%

³ The study was conducted in a partnership with the Romanian-German Chamber of Commerce and Industry, the Austrian Chamber of Commerce and the Romanian-Swiss Chamber of Commerce, in the period between November 2009 - January 2010.

say that these have the necessary knowledge.

Another problem encountered is the complexity of tax forms, over 40% of the respondents believing that tax forms are difficult to understand and complete.

In these circumstances, the respondents would like to see more

consistency and predictability, and the most required change is to reduce rates for social insurance, especially health insurance contribution, since their value does not bring real benefits to taxpayers.

However, respondents say that corporate tax and VAT are considered to have an acceptable level.

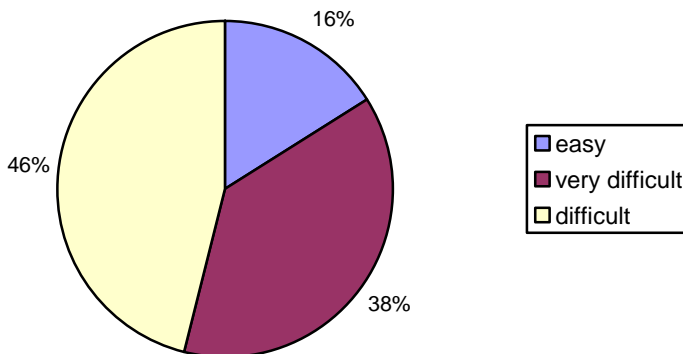


Fig. no.3 – The characteristic of the local financial environment

3. Conclusions

The most obvious conclusion is also based on facts revealed by another study published in 2009, study conducted by the European EVCA - Evergreen Venture Capital Association and the Tax Services for Mergers and Acquisitions of KPMG, which draws a warning for whoever wants to hear it.

In this respect, Business Standard, quoting the KPMG study pointed out that tax and legal environment in Romania is one of the most unfriendly of Europe.

On a scale from 1 to 3, where 1 is the highest score, Romania received a

score of 2.27 points, thus occupying the 24th position in a ranking of the 27 EU countries.

The results of this study are interesting because they show that many countries which are traditionally considered to have high taxes provide an environment that encourages investment by venture capital and private equity. Unlike them, other EU Member States, as is the case of Romania, with lower rates of corporation tax and personal income tax, do not occupy good positions.

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