



American Chamber of Commerce  
in Romania

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**Tax Position Paper** – submitted to the Ministry of Economy and Finance on February 15, 2008.

## **1. General Recommendations**

**1.1. General Taxation Principles** – the general taxation principles should be introduced in the current legislation and observed when adopting new provisions. These are: the neutrality of fiscal measures principle, the economic efficiency principle, the taxation of benefit principle, the payment capacity principle, the economic growth principle, the correlation of budgetary income and spending principle, the principle of stability, the principle of simplicity, the principle of reduced tax administration costs. These principles were previously detailed in documents submitted by AmCham Romania to the Ministry of Economy and Finance and can be made available upon request.

**1.2. Substance over Form Principle** – we suggest that when assessing the observance of the tax legislation, the Romanian tax authorities should make an in-depth analysis of the substance of the transactions performed by the taxpayers, instead of being focused on the form of the transactions (e.g. expenses backed up by invoices which do not have all the details filled in are not accepted for deductibility). The substance over form principle should be introduced in the legislation.

**1.3. Contradictions between Laws** – the definitions, concepts, notions used in the provisions of the Fiscal Code, Fiscal Procedures Code and other pieces of fiscal and economic legislation should be correlated in order to avoid confusion and misinterpretation. For example the provisions in the Fiscal Code are in some cases in contradiction with the legal provisions in the Company Law and Accounting Law.

**1.4. Fiscal Code and the Application Norms** – given the many amendments made along way, both legislative pieces should be republished in order to be easier to follow their provisions.

## **2. Fiscal Recommendations**

**2.1. Annual Reporting for Profit Tax (With Quarterly Advance Payments)** - under Government Emergency Ordinance (OUG 106/2007) the extension to all companies of the annual reporting system for corporate tax (with quarterly advance payments) has been postponed until 2010, instead of applying from 2008 as envisaged in the 2007 Fiscal Code. A much more confusing system will now apply, with some companies reporting annually while others will have to continue to carry out a full accounting exercise every quarter. Annual reporting has applied to banks since 1 January 2007. From 1 January 2008 it will apply also to three further categories: firstly to new businesses set up in the 2007 fiscal year, secondly to companies reporting a fiscal loss in the previous year, and thirdly to micro-enterprises which paid income tax during the previous year, but which starting 1 January 2007 became profit tax payers, because their turnover exceeded the limits for a micro-enterprise.

Applying the annual reporting system (with quarterly advance payments) to all companies would be much simpler, relieving the state authorities of a considerable administrative burden. It would also bring Romania into line with practice in most other EU countries. In the long term, it would increase budget revenue, because companies would have to spend less time and resources on tax administration, and so could concentrate on developing their business, hence contributing to economic growth. Tax inspectors' work would be made easier, thereby allowing resources to be reallocated to more critical areas, such as tackling tax fraud. The change has been advocated for some time by many representatives of the Romanian business community. It is all the more urgent now that Romania is a member of the EU, and companies face the competitive pressures of the European Single Market.

**2.2. Bad debts written off** – their deductibility should be 100% allowed under the Fiscal Code with no further restrictions;

**2.3. Level of deductible interest rate for loans denominated in RON** - the deductibility of interest on loans contracted from non-financial institutions is limited to 6% for foreign currency denominated loans and to the National Bank of Romania reference interest rate for loans denominated in RON. Interest exceeding these limits is non-deductible. During the last period, the reference interest rate is used by the National Bank on Romania as a tool for managing macro-economical processes. The significant fluctuation in the reference interest rate in 2007(8.75% in January to 6.1% in August) artificially impacts the fiscal results of Romanian companies with loans denominated in RON. **Proposal:** the level of interest rate which is tax deductible should be computed based on similar algorithms for loans denominated in foreign currencies and for loans denominated in RON. A suggestion would be to use during the entire fiscal year a flat interest rate for the loans denominated in RON.

**2.4. Investment funds** – additional clarifications should be provided in the Fiscal Code regarding the taxation regime applicable to the investments funds. Additionally, clarifications regarding the practical procedure for non-residents appointing tax agents in Romania to fulfill the tax obligations on their behalf should be included in the fiscal legislation.

**2.5. VAT in customs and on real estate** – the VAT reverse charge mechanism should be applied, as the VAT pre-financing is a real burden for investors. Most EU countries (e.g. Austria, Belgium, Netherlands, Italy, Ireland, Luxembourg, etc.) apply the VAT reverse charge mechanism for imports.

The measures for simplification (the reverse charge mechanism) proved to have a positive impact upon development of the business environment in 2007, whereas abandonment of them represents a brake for the economic development of Romania. Abandonment of the simplification procedures (the reverse charge mechanism) in the situations above does not mean extra revenues for the state budget, nor does it represent an improvement in the collection of VAT, but rather it is merely a prolongation of the period in which VAT paid is retained at the disposal of the Government, with a view to utilization; it becomes anyhow deductible - with the VAT reimbursement claim - on the 25<sup>th</sup> of the month following that in which the taxable event took place.

From the taxpayer prospective, effective payment of VAT has as its direct consequence an increase of the financial costs and an immediate reflection in the increase in the prices of the goods supplied. At the macroeconomic level, this rise in prices will be reflected in a growth in the consumer price index, which may generate difficulties in terms of the control that both the Government and the National Bank of Romania attempt to exert upon inflation.

Taking into account the above, we solicit an urgent return to the previously existing provisions of the Fiscal Code as regards measures for simplification of VAT payments.

**2.6. Local Authorities' Prohibitive Taxes on Investors** – Local Authorities impose prohibitive taxes on investors. For example building tax is currently 1.5% of the book value, thus becoming more and more a barrier for investors. The 1.5% paid by companies is equivalent in many cases with the rent for 2-4

months, which means 15 - 30% of the income (net profit) generated by the building from rent. On the other hand private individuals pay up to 100 times less than companies for commercial properties. This system is encouraging developments by private individuals - and that is where the biggest tax evasion is. This is affecting the level playing field, since foreign investors do not generally have this option.

### **3. Social Insurance Related Recommendations**

**Social Contributions** – the uncapping of the social contributions lead to a huge burden on the investors who wish to attract skilled personnel and pay adequate salaries. A cap on the tax base for all contributions should be enforced and it should be at a reasonable level (e.g. 3-4 times the average salary). On the other hand, the Government can collect more contributions from extending the tax base by eliminating the possibilities to abuse the current legislation. Including the social contributions and other taxes provided under various pieces of legislation in the Fiscal Code may help having a better regulatory framework for calculation and collection of the social contributions.

### **4. Business Climate Related Recommendations**

**4.1. Correlation between ANAF's and MEF's Legislation Departments** - Romania's accession to the EU implied from the tax point of view the adoption of new legal provisions, harmonized with European legislation. Both taxpayers and tax authorities have been making huge efforts to assimilate the new legal provisions as quickly as possible. Nevertheless, in practice we have been able to ascertain a lack of correlation between the approach to the same tax provisions on the part of the tax inspectors subordinate to the ANAF and that of the Legislation Departments of the MEF. For this reason, we consider that participation of ANAF representatives in the process of redacting tax legislation to be absolutely necessary and we suggest that in order to facilitate dialogue there should be periodic meetings for consultation, to which should be invited representatives of the ANAF, representatives of the Legislation Departments of the MEF and representatives from the business community. Our representatives are fully available to participate at any such meetings.

**4.2. Fiscal Registration of Non-EU Residents and Declaration of Their Income** - non-residents' fiscal registration procedures and the procedures to declare their income made in Romania must be clarified, having in mind that currently, these procedures are spread out in the Fiscal Code and Fiscal Procedures Code under various articles, and there is no clear procedure regarding the obligations non-residents have in Romania. We also request including these procedures in the Fiscal Procedures Code.

**4.3. Lack of Consultation** – when relevant authorities consider amending the fiscal legislation they should consult and ask for the feedback of the business community within the appropriate period of time stipulated in the Law 52/2003 regarding public administration decision-making transparency, and the amendments should be made observing the provisions of Art. 4 in the Fiscal Code.

**4.4. Content of the Fiscal Code** – we suggest the inclusion in the Fiscal Code of all taxes mentioned in various pieces of legislation since they represent income sources to the state consolidated budget and should be controlled by MEF.

**4.5. Ministry of Economy & Finance and EU** – given the need to harmonize the Romanian legislation with the EU legislation, the legislation proposed by the Ministry of Finance should be correlated with the existing European legislation.

**4.6. Economic Double Taxation** – in essence, economic double taxation represents taxation of income obtained by entrepreneurs (shareholders in commercial companies) at two levels: the company level and the individual level.

In most European countries, measures have been taken over time to avoid the negative impact of

economic double taxation on the business environment. To this end, European tax legislation presents provisions that either imply the abandonment of tax on dividends or a reduction of the rate of their taxation in such a way that, cumulatively, the corporate profit tax and the tax on dividends generate a total tax burden equal for both entrepreneurs who have set up a company and individuals who carry on economic activities individually.

Given the technicality of such provisions, we are ready to place at your disposal extracts from the tax legislation of EU member states and likewise, should you consider it necessary, to participate in the capacity of experts in any discussions that might result in alignment of Romanian and European tax legislation from the point of view of economic double taxation.

**4.7. Investment Law** – a draft of the Investment law has been in discussion for a long period of time (i.e. since 2006), however no progress has been made in order to see this piece of legislation become reality. A clearly written law, not leaving room for interpretation, has the potential to bring Romania many advantages, both in its national context and EU membership one.