

HOW TO AUTHORIZE MY BUSINESS?

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This paper intends to present the authorization alternatives for a business. We analyze the characteristics of each model of organization and the implications of choice on the activities of the potential business.

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There are two major categories of economic activity forms of organization: entities without legal personality: (authorized person (PFA), family business (ÎF) or individual business (ÎI)) and entities with legal personality, called companies⁵⁵ (we focus on limited liability companies as being the most used form of organization). Each alternative has strengths and weaknesses starting from the constitution moment: costs, required documentation, time needed, tax level, statements required, accounting and monitoring requirements, legal responsibilities, material and financial needs, etc.

Why SRL? The limited liability company is a company who's social liabilities are guaranteed with the company's patrimony and the associates are responsible in accordance with their share capital (at least 200 RON in Romania). Personal wealth is well protected, the associates being responsible for any prejudices with their shares of capital. Thus, if after the bankruptcy and liquidation of the company there are creditors still unpaid, they will not be entitled to be compensated from the associates' wealth.

A company is founded by association of individuals and/or legal persons, Romanian or foreign. In the case of limited liability companies having a sole partner, two rules must be met: (1) an individual or a legal person can be sole partner in only one limited liability company; (2) a limited liability company cannot have as sole partner another limited liability company, having only one partner.

What is an Authorized Person? An authorized person is an individual conducting any form of economic activity permitted by the law, by using its abilities. The economic activity may be agricultural, industrial, commercial, and it is focused on producing goods or services expressed in monetary terms, intended for sale or exchange on established markets or to certain beneficiaries in order to obtain profit.

In addition, there exists the **individual business**, which is a PFA able to hire personnel.

Or Family Business? A family business is formed by an agreement of incorporation, signed by family members (who have reached the age of 18 years, for the individuals initiating the family business, and the age of 16 years for the members of the family business) in writing, as a validity condition. The agreement of incorporation includes the first and last name of the members, the representative, the date of signature, the contribution of each member to the business, conditions of participation, net income distribution quotes, the relationship between the members and the retiring conditions, under penalty of absolute nullity.

⁵⁵ Legea 31/1990, republicată, cu modificările și completările ulterioare

To carry out economic activities independently, the following conditions must be met: (1) to be over 18 years old; (2) health state proven by medical certificate, allowing them to conduct the authorized operations.; (3) to have the requested quality for this activity; (4) to have special authorization issued by authorities, according to the law, for economic activities implying special authorizations; (5) that he was not convicted by court for committing crimes on the legal system for certain activities or for forgery; (5) that operating conditions are met in accordance with the sanitary, veterinary, environmental, labour and fire regulations and consumer protection regulations, and also the quality requirements for the goods and services issued on the market.

Tax issues

Authorized persons, according to CAEN code (the code of the activity conducted), can be grouped in payers of bracket income taxes or payers of net income tax.

What is **income tax bracket**? This is an income expected to be gained by authorized persons and is calculated by 1st of January next year, according to Fiscal Administration County Agencies regulations. This income bracket tax is determined for each CAEN code on the basis of government decision, taking into account the location of the authorized person.

How is calculated the income tax for these authorized persons? A rate of 16% is applied on the bracket income established by the Tax Administration Agency of the territory, resulting in a yearly income tax to be paid, amount recorded in "Taxation decision for tax prepayments as of year N" and transmitted each year at the headquarters of the authorized person. This amount is paid quarterly, in cash, at local tax administration cash desks.

There are no accounting recordings needed for this type of authorized person. For the internal control of income and expenses, the entity keeps only the invoices and receipts issued to customers or received from providers.

Are there any other liabilities to be paid by authorized persons, included in the bracket income?

There are also other liabilities to be paid by authorized persons, as follows: 5.5% applied to bracket income, as contribution to health social insurance, 31.3% applied monthly to a quarter of annual average gross wage (for 2009 – 1,693 RON) and optionally the contribution to unemployment fund: 3.5% of the gross minimum wage (600 RON for 2009).

Is there any other information to be taken into account in determining the liabilities to the state?

There are also some facilities: if the individual registered as authorized person is working and is employed with record of employment, he benefits of a 50% deduction of these liabilities. This is justified by the fact that only half of the labour time is allocated for the PFA, the other half being used on the main working place. In other words, taxes are determined for half of the worktime. There are also *special situations* such as:

- when a taxpayer is self-employed on periods shorter than a year, the bracket income for this activity is adjusted in order to reflect the period the activity was carried out.;
- when a taxpayer carries out two or more activities, the net income of these activities is determined as the highest bracket income for them..

For the authorized persons (PFA), family businesses and individual businesses being taxed on the net income, the Tax Administration calculates an annual tax to be prepaid quarterly, in equal rates, on the basis of the estimated income statement. The term and the amount to be paid are communicated by a decision of prepayment sent home by mail. At the beginning of the year, an estimated value of the net income is declared and a single tax of 16% is calculated, representing a prepayment tax. Until May 15 of the following year, a Special Statement of income for the previous year is submitted, followed by the issuance of a decision regarding the final amount of tax to be paid.

The net income or fiscal loss is determined as follows:

Of the total amounts received, recorded in the Journal of receipts and payments, less::
assets depreciation expenses, recorded in Various operations sheet;
total amounts paid, recorded in the Journal of receipts and payments;

plus:

- the amounts paid for redeemable goods purchases;
- total non-deductible expenses, taken from non-deductible expenses table.

Deductible expenses are those expenses strictly necessary for the basic activity, ie those undertaken for a proper functioning (supplies, services, furniture, computers, salaries, etc.).

Non-deductible expenses are those expenses incurred by PFA, ÎI or ÎF, but considered unnecessary for the main activity of the company, such as: for an IT business the expenses with cosmetics are not deductible. This example highlights the connection between the main activity and the nature of deductible expenses.

Warning! Even in this situation, the contributions to health insurance and social insurance (pension) must be paid. Things get complicated when the company employs personnel, because the business must comply with the law for employers, meaning employees time sheets, monthly payrolls, contributions owed and paid to the state as employer and for employees, statements to ANAF, CASS, CAS, AJOFM, tax statements... we suggest that the company uses professional services provided by experts.

For those intending to found a **company**, when they register it at the County Tax Administration they must choose between microbusiness and small business, choice that affects the methodology of tax determination, accounting and liabilities regarding the employees.

In the case of *microbusinesses* we must consider the turnover and the number of employees. Regarding the number of employees, a microbusiness must have at least 1 employee (and a maximum of 9 employees) within 60 days of its establishment; if the company has no employees, it will be taxed on profits. Another condition is that the turnover must be less than 100,000 EUR/year (estimated to an exchange rate established at the beginning of each year for the previous one by the Tax Administration National Agency). There are two more conditions for a company to be considered a microbusiness: to have revenues, other than those from consulting and management activities representing more than 50% of total revenues, and the share capital to be owned by other entities than the state, local authorities and public institutions. All four conditions must be met simultaneously. The major disadvantage is that beginning with 2010 this tax regime is not available anymore.

If we do not intend to register the company as microbusiness or it does not meet the conditions specified above, then it must be considered income tax payer. The income tax is of 16% and is calculated on the difference between total income and total expenses incurred in the activity of obtaining revenues, in a fiscal year, deducting non-taxable income and adding non-deductible expenses. The advantage of companies is that the range of deductible expenses is larger than that of entities without legal personality. The non-deductible are clearly specified in the Fiscal Code: expenses with penalties from the state authorities, entertaining and promotion expenses over 2% of the profit, or total entertaining and promotion expenses when the company operates at loss, transportation expenses if exceed 2.5 x the level for public institutions, etc. The concept of non-taxable income is highlighted, representing amounts received by the company, previously taxed, such as dividends. We do not focus on this issue here as the accounting of each company is entrusted to a person having economic studies, and the balance sheet is signed by an expert accountant, so that the company must cooperate directly with professionals. Companies must pay income tax quarterly.

Starting from May 1st 2009, the Romanian government issued an ordinance for a lump sum tax to be paid by companies. This lump sum tax is determined on the income obtained and declared. The companies with a turnover between 0 and 52,000 RON (about 12,000 EUR) will pay a lump sum tax of 1,467 RON (500 EUR) for 2009. The companies having a turnover between 52,001 and 215,000 RON (50,000 EUR) will pay a lump sum tax between 2,867 RON and 4,300 RON (1,000 EUR) for 2010. The companies with a turnover between 215,001 and 430,000 RON will pay 4,333 RON for 2009 and 6,500 RON for 2010. The companies operating on profit will pay

16% on the net income, but not less than the lump sum tax for the corresponding turnover. For microenterprises the annual lump sum tax is of 2,200 RON, payable quarterly.

If the company employs personnel, the amount of contribution to be payed to various public budgets diversifies, including health insurance contribution of 5.5% for the employer and 5.5% for employees, social insurance (pension) 20.8 % for the employer and 10.5% for employees, unemployment fund 0.5% for the employer and 0.5% for employees, contingency fund depending of CAEN code between 0.15 and 0.85% only for the employer, wages claims guarantee fund of 0.25% only for the employer, allowance and vacation fund 0.85% only for the employer, record of employment fee 0.25% or 0.75% only for the employer. All these contributions are determined on the gross wages.

In addition to these liabilities regarding the employees, the company must pay the sanitation tax, TV and radio tax included on the electricity bill, advertising tax, building and auto tax (if the company owns buildings or autos), varying from county to county, with the exception of the TV tax.

To be or not to be a VAT payer? This question arises in every potential business women's mind, and the answer must be given after taking into account the following issues: (1) who are the major customers? If they are companies, they will request the invoices issued by you to include the VAT deductible, otherwise it is not necessary to complicate the accounting process and the statements to be prepared (declaration of mentions 010 that records the VAT and: sales registry, purchases registry, quarterly VAT deduction); (2) it can provide 19% cheaper products if we consider the final consumer. There can be VAT payers both companies and PFA, ÎI and ÎF. This registration can be done by request or by default if the turnover exceeds 35,000 EUR annually. Attention! A company can become VAT payer from VAT nonpayer, but never reverse.

Benefits of PFA real system compared to lump sum taxation: (1) acknowledge the right to become employer; (2) acknowledge the expenses; (3) taxation on net income if this is lower than the bracket income tax. Disadvantages: (1) the payment of higher taxes if net income exceeds the bracket income; (2) compulsoriness of recording these amounts in the registries.

Benefits of ÎI and ÎF compared to PFA: they can be considered employers – they can hire personnel, and ÎF can employ family members.

Benefit of SRL compared to entities without legal personality: extended range of deductible expenses. Disadvantages: (1) dividend tax, (2) withdrawals of money from the company can be done only by the end of the fiscal year, (3) lump sum tax; (4) income and expenses recognition moment.

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