

## THE LUMP-SUM TAX – SOLUTION FOR DIMINISHING TAX DODGING AND RAISING OF THE BUDGETARY INCOMES –

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*The lump-sum tax was applied in our country for a few decades, but only in the case of certain natural persons that carried on certain economical activities. The applying of the lump-sum tax in the case of enterprises is a novelty in the Romanian fiscal system.*

*The lump-sum tax can be defined as a compulsory payment, established as fixed sum by the public administration organs respecting the legal foresights, for the natural and legal persons and paid from their income.*

*Levying this lump-sum tax on firms is a measure that aims to oblige the tax dodgers to pay a minimal contribution to the budget of the state.*

*Key words: lump-sum tax, tax rate, taxable profit, tax dodging, fiscal equity*

*Code JEL:H25.*

As it is well known, in the last period of time some discussions took place, all kind of ideas were issued by all means of information, having as subject the intention of the Public Ministry of Finances to introduce a lump-sum tax, concerning the commercial societies that record losses, and in this way don't pay at all to the state the profit tax. Initially, there were aimed the companies that carry on their activity in six domains of national economy: food industry, drinks industry, the en-gross and retail trade, hotels and restaurants, real-estate and constructing transactions.

Subsequent, the finances minister announced that the constructions societies will be submitted to the lump-sum tax, this, from my point of view, being a fair measure, as I will try to argue in the following.

From the report of "Gândul" newspaper it results that the minister of finances has argued his decision of introducing the lump-sum tax on the fact that, from the approximately 680.000 of commercial societies that carry on their activity in the national economy level, approximately 12.000 ensure over 85% from the public incomes, and the companies that operate in the mentioned six economic fields are responsible of 70% from the net loss of 2007 of all companies from Romania.

Towards the Public Finances Ministry's intention to introduce the lump-sum tax, there were emitted lots of points of view, but I believe that, the most relevant ones are the one expressed by the business society from Romania. In this way, according to the information accessed on the internet, Mr. Ovidiu Nicolescu president of the National Council of Small and Medium Sized Private Enterprises in Romania argues the introduction of a lump-sum tax as a possibility of avoiding the overstating of lump-sum tax, with the condition that this one to be established depending on the average profit upon activity categories. On the other hand, Mr. Florin Pogonaru, president of Romanian Businessmen Association argues that the introduction of a lump-sum tax would be a tardy measure, the European states in which this system is applied trying to eliminate this method of taxation, under the conditions of the financial crisis, because it might pull down activity areas, like constructions where most of the companies have losses. In

his opinion, the establishing of a fixed sum that the economic operator would have to pay, would mean to pay this money no matter if the company had or had not any profit at all.

*The lump-sum tax* was applied in our country till the end of 1999, but only in the case of certain natural persons that carried on certain economical activities. The applying of the lump-sum tax in the case of commercial societies would be a novelty in the Romanian fiscal system. Although the lump-sum tax in the case of natural persons has been applied since certain decades, no normative document that stipulated the applying of this kind of tax, gave any definition to the lump-sum tax. In this way, the Decree no. 153/1954 regarding the income tax of population, stipulated the applying of lump-sum tax for some categories of workmen, but without defining the conception of lump-sum tax.

Sometimes, for some categories of tax payers, special normative documents were issued. This way, by Government's Order no. 11/1992 concerning the way of the taxi activity deployment, it has been established that the natural persons that deploy taxi activity to be submitted to a trimester lump-sum tax of 30.000 lei.

Subsequently, by Government's Urgency Order no. 85/1997 concerning the taxation of the obtained incomes by the natural persons, that was in operation during 1<sup>st</sup> of January 1998 – 31 of December 1999, there were abrogated all normative documents that regulated the taxing of the incomes obtained from the carrying on of certain economical activities by natural persons, but the application area of the lump-sum tax has extended. So, the tax payers that deployed exclusively trade activity in many places, carriers with animal traction ways of transport and circulating craftsmen were obliged to the paying of a trimester lump-sum tax that was decided by means of the county councils decision or of the Bucharest Town General Council. The authorized natural persons, and also the collaborators of the commercial societies that deployed taxi activity with their on personal cars, were obliged to a trimester lump-sum tax of 400.000 lei that could be increased or diminished with up to 50%, depending on the concrete conditions of practicing of this activity from each locality.

In the Romanian explanatory dictionaries it is stipulated that the word '*minimum tax*' is used when the discussion is about tariffs, taxes, duties, payments; it is before established as a global and invariable fixed or unvaryingly sum.

As it is well known, the *tax rate* represents the *compulsory, general and definitive money draw* realized by the state from the incomes or fortune of natural and/or legal persons in the terms and quantum stipulated by law, towards covering the public outgoings and intervention of the state in the society and economy, without any obligation of this one to carry out any equivalent and immediate duty.

So, the lump-sum tax can be defined as a compulsory payment, established as fixed sum by the public administration organs respecting the legal foresights, for the individual and/or juridical individuals and paid from their incomes.

The introduction of the lump-sum tax is not a new idea in the Romanian fiscal politics. So, in the beginnings of 2001, Premier Adrian Năstase announced the introduction of a profit tax as fixed sum (minimum tax) for companies with less than 20 employees and with a business sum of 100.000 euros. Subsequently, the idea was dropped and, starting with 01.09.2001 it was introduced the income tax for small enterprises by applying of a percentage share on the established incomes.

At that time, the motivation was the high share of the profit tax rate (25%) that determined the growth of hauling times in the underground economy, ways by which the fiscal pressure is avoided. It was motivated then, the same way that it is nowadays too, that the introduction of lump-sum tax will diminish the motivation for tax evasion.

The introduction of lump-sum tax was abandoned until the summer of 2007, when Premier Călin Popescu Țăriceanu announced the introduction of this type of tax rate for panification factories, arguing that in this field the tax evasion reaches alarming dimensions of 60 – 70%.

The idea of introducing of the lump-sum tax was resumed by the actual govern, when Mr. Ghe. Pogea announced that a lump-sum tax will be introduced for six types of businesses, the scope being the growing of the incomes of the state budget, the motivation being that the majority of the companies don't pay the profit tax. To sustain his affirmations Mr. Minister was showing that from approximately 680.000 of companies that have laid down the financial statements corresponding to 2007, about 12.000 assure approximately 85% from public incomes, which means that the immense majority of companies don't contribute at all. From the information supplied by mass-media, in conformity with the analysis made by the Finances Minister for 2007, approximately 242.000 companies (almost 39%) from the registered societies have had losses. If we report the number of companies with losses to the ones that have laid down the annual financial statements, the percentage is of approximately 35.6%, but neither this percentage reflects the degree of profit of the Romanian companies, affirmation that I will sustain in what will follow. The 35.6% percentage resulted from an empirical calculus is very close to the 35 – 37% percentage sustained by Mr. Florin Pogănaru, the president of the Romanian Businessmen Association, in conformity with the Newsletter publication.

Because the press information and the ones posted on the internet regarding the introduction of the lump-sum tax can represent an interpretation and analyzing problem for many persons with economical studies, and not only for them, I have realized an analysis of the financial statements corresponding to semester I of 2008, that are laid down by the commercial societies from Dolj county.

So, from the total of 17.481 of companies that have laid down the financial statements on semester I of 2008, 2.389 of them have paid the *small enterprises profit tax*, by paying a medium monthly tax of 224 lei, and 4.192 of companies have paid the profit tax a monthly average of 1.813 lei. On the other hand, from the total of companies that have paid tax profit, approximately 1.600 of them do not have any employee at all, which denatures and makes more difficult any analysis of the profit of Romanian companies. At first sight, this would mean that approximately 11.000 companies have had great losses in the activity from the first semester of 2008. It is a false impression, because approximately 5.500 companies have laid down financial statements that were "zero" meaning that they did not have any incomes, nor outgoings, so they did not have any activity at all. So it results that the firms that had fiscal losses were about 5.500, which represents approximately 46% from the total 11.970 of active companies.

The question that is imposed is if these companies can work with losses on long period of times without needing a credit. It is very well known that for companies with losses the access to bank credits is denied, and then, to finance the activity, the employers credit their societies with personal money. As long as the companies have accomplished losses many subsequent years, the money can not come from anything else than tax dodging.

If we make an analysis of the tax rate paid by the societies from Dolj in the first semester of 2008, we can draw pertinent conclusions that will sustain the measure of introducing the lump-sum tax.

In this way, in the case of small companies, it results that on a tax rate of 224 lei, the monthly average income is about 8.970 lei. Most societies (approximately 51% in Dolj) are commerce-based activities, and assuming, for easy analysis, a 10% gross margin, the income obtained from the trade markup is 900 lei per month. A very simple and pertinent question is imposed, that I believe that not even the greatest "expert in financial engineering" can respond to, with real credible arguments: if the firm has had at least one employee to whom the minimum economy salary was paid to, if the firm paid the social taxes owed by the employer and also the utilities (energy, water, sewer, gases, etc), from where does the employer - as single associate earn his living, and most of the cases his family's too? The answer can only be one: *tax dodging*.

From the above shown, and the affirmations of government officials from the last years, results that the tax dodging is a wide-spread phenomenon in Romania, that is difficult to be kept under

control by the organ fiscal. The only solution to oblige the hundred of thousands of tax dodgers to pay the tax rate was to introduce a minimum tax rate, established based on certain criterions.

The reaction of businessmen towards the introduction of tax lump-sum tax was different, the majority harshly criticizing these measures, explaining that in the crisis period in which we are all in it is not opportune the taking of this measure that would lead to bankruptcies of 10 thousands of companies and, as a consequence, the growth with some hundred of thousands of unemployed persons. If we make an analysis of the lump-sum tax, as it was negotiated by the govern and the representatives of businessmen and adopted by the urgency order<sup>6</sup>, we will see that their affirmations are exaggerated.

Before making an analysis of the lump-sum tax, as it was adopted by the govern, I consider that some observations are necessary concerning what it was negotiated, what was published in mass-media and what was adopted by the governs' urgent order. So, if the opinions of negotiators (govern, employers, syndicates) let to understand that the new system of taxing for the commercial society is lump-sum tax, after the analysis of stipulations from the normative document, we reach the conclusion that the so announced "lump-sum tax" is a minimum tax rate, already used in the case of societies that deploy their activity in the following domains: night bars, night clubs, discos, casinos and sporting bets, that any commercial society registered in Romania has to pay, no matter if it operate or not, if it has incomes or not, in the case when the income tax from the current year is smaller than the minimum one established depending on the business sum of money obtained in the preceding year.

Another observation is that the way that the legal normative documents state, without any "decisional transparency" the Govern took the measure of taxing the firms without any activity, was considered by the majority of persons that have economical and fiscal tangencies in harsh terms. Referring to this measure, I consider that a small comment must be made. So, I have previously shown that over 30% from the companies that have laid down the financial statements do not have any activity at all. According to the legal stipulations, these firms are in activity: they have laid down the financial statements, and the fiscal statements, but all of them are "zero"; the reason? For not being punished in contravention, and the main reason for not to be crossed of from the Register of Commerce due to not laying down of the financial statements.

Taking into consideration the useless costs that are endured by the fiscal administration for directing these tax payers, as long as there are not any legal stipulations of "crossing of" such kind of companies that harm the Romanian society (can there be estimated the costs of directing these firms by the state institutions: the National Fiscal Administration Agency, the Register of Commerce?), measure that was initially issued by the Finances Ministry and approved by the govern, that even although it breaks the basis principles of taxation, I consider to be a coercive measure applied to these societies, to determine them to act properly: either they start to have activity, or they are crossed of from the Register of Commerce. In the actual situation, it is difficult to presume that there will be many companies that will begin to have activity, the only way to escape from the tax rate being the dissolving of those societies, which is a slightly difficult and long procedure, according to the legal in operation stipulations. If there will be established debits for the duty of these tax payers, it is difficult to assume that they will be sometimes taken back. This is why, I consider that it is imposed the elaboration of a normative document by which to dispose of the immediate dissolving of these societies, excepting the ones that are in the evidence of the fiscal organs with debts, and also the ones that did not have any activity at all from their setting up (they did not have laid down the financial statements, according to the legal stipulations<sup>7</sup>).

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6 O.U.G. no. 34/11.04.2009 published in Of. M. no.249/14.04.2009, concerning the budgetary rectification on 2009 and regulating some fiscal - financial measures

7 Art. 36 align (3) from Law no. 82/1991 the accounting law, republished in Of. M. no. 454/18.06.2008

The tax rate, the taxable profit and the rate of return for the maximum incomes, according to the lump-sum tax grid are shown below:

Total annual incomes (lei)	minim annual tax (lei)	Tax rate	Taxable profit	Rate of return for the incomes
1	2	3 = 2/maximum income from taxing grid	4 = 2/16%	5 = 4/maximum income from taxing grid
0 - 52.000	2.200	4,23%	13.750	26,4%
52.001 – 215.000	4.300	2%	26.875	12,5%
215.001 – 430.000	6.500	1,5%	40.625	9,4%
430.001 – 4.300.000	8.600	0,2%	53.750	1,25%
4.300.001 – 21.500.000	11.000	0,05%	68.750	0,32%
21.500.001 – 129.000.000	22.000	0,017%	137.500	0,11%
Above 129.000.001	43.000	0,033%	268.750	

If we analyze the minimum established tax rate, reported to the maximum business sum, in accordance with the taxing grid, we notice that there are huge discrepancies in this tax rate, for which there can not be brought any sustainable economical or financial arguments. So, it is easily noticed that the small companies, the term that it is used to describe them in the fiscal legislation<sup>8</sup>, have been divided in 3 taxing grids. Basing on the above presented argumentation, it results that companies that accomplish a positive but less than 52.000 lei incomes, and also the most majority of the ones that accomplish an income between 52.000 – 215.000 lei can not survive without making tax dodging. If we compare the current 3% turnover tax of small and medium sized enterprises (100.000 euro = 430.000 lei X 3% = 12.900 lei), to the lump-sum tax we notice that the lump-tax is about 50% (6500 lei), which can only represent a measure of fiscal relaxation, that is valid not only in the case of small enterprises.

For the first 3 categories from the taxing grid, the regression of the tax is acceptable. Starting with the 4<sup>th</sup> category, there are major differences between the incomes and the minimum due tax, and this is, in terms of economic and financial analysis, *unacceptable*. Analyzing the data from the table presented above it is clear that firms that had over 100000 euro incomes in the previous year are more advantaged in terms of “lump-sum” tax than the small or medium sized enterprises, so the fiscal relaxation is much more consistent. Of course, we exclude those firms that reported losses in the previous year.

If we analyze the companies with over 260 millions lei incomes that have under 0.10% profit rate we notice that fiscal relaxation is directly proportional with incomes. If we look to the data in the table we can see that is no correlation between income category and due tax. The incomes in the 4<sup>th</sup> category are 10 times bigger than the 3<sup>rd</sup> category ones, but the tax is only by 1.32. The incomes in the 5<sup>th</sup> category are 5 times bigger than the 4<sup>th</sup> category ones, but the tax is only by 1.28. The incomes in the 6<sup>th</sup> category are 6 times bigger compared to the 5<sup>th</sup> category ones and the tax is only twice as high.

### **Conclusions**

Taking into consideration the high level of tax dodging, stated not only by public institutions but also by businessmen and professionals in the field of economy and finance, introducing the lump-sum tax is a welcomed measure, in the absence of other legal provisions, to attract some incomes

<sup>8</sup> Art. 103 from Law no. 571/2003 concerning the Fiscal Code

to the state budget from the underground economy relating to the profit or income tax, because other kind of incomes can't be obtained by such measures (social contributions, value added tax etc.). The ways to establish the lump-sum tax can be improved so that the tax amount that the companies have to pay should reflect a basic principle – that of the *fiscal equity*.

As a final conclusion, diminishing tax dodging can't be done only by fiscal measures; it has to be correlated to other economic or social measures.

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