

# CHOOSING THE RIGHT FORM OF LICENSING A BUSINESS IN ROMANIA

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*Choosing the most appropriate form of licensing a business is an important decision not easy to be made by an entrepreneur and it should be taken only after he has the required skills and abilities to do so. The business idea should harmonize with the business environment and its future trends, with the existing opportunities and the future products or services that the company will provide and not least the entrepreneur has to make sure that he has sufficient resources to get started.*

*We consider that every business has a number of features that make certain forms of licensing to be more suitable than others.*

*This paper aims to present a multitude of items to be reviewed by an entrepreneur at the start-up in order to choose the most appropriate licensing type for his business.*

*Given that our country's law allows entrepreneurs to license their businesses in several forms, the decision to choose between many existing possibilities is a very important one for the future good of the business.*

*Currently in our country there are two major laws governing the licensing of a business. The first one is the republished and subsequently amended Company Law number 31/1990 and the second, the Government Emergency Ordinance number 44/2008 regarding the economic activities of the Sole traders, Individual enterprises and Family enterprises.*

*The Company Law number 31/1990 allows companies to choose between one of the five types of business entities that can operate in Romania: General partnership (in Romanian SNC), Limited partnership (in Romanian SCS), Limited partnerships by shares (in Romanian SCA), Joint stock company (in Romanian S.A.) and Limited liability company (in Romanian S.R.L.).*

*GEO number 44/2008 on economic activities of the Sole traders, Individual enterprises and Family enterprises regulates the licensing and the activity of a Sole traders, Individual enterprises and Family enterprises.*

*Key words: business licensing, types of business entities, Sole traders, Individual enterprises, Family enterprises*

*JEL Classification: M10,M19*

## **Introduction**

Certainly, not every person has the necessary skills and abilities to license and develop a business. Once a potential entrepreneur succeeds to auto evaluate himself and concludes that he holds a minimum of necessary knowledge for starting a business, that he has certain qualities that recommend this approach, that he is an ambitious person with a very good health condition that allows him in the near future to initiate and develop a business, the next step has to be taken. This future entrepreneur must find an answer to the question: "which business type would be the best for me?" In order to answer this question correctly, the entrepreneur should start from his own knowledge, skills, abilities, but also has to take in consideration the business environment's characteristics, trends and peculiarities that may occur, the aim for business analysis being to identify the business's opportunities, specific for a certain area and period.

Only after getting to know the idea of a business, the entrepreneur should focus on another question: "Which is the best licensing type for my business?"

As stated above, the legislation in our country allows various forms of business licensing. These authorization forms are largely presented in two main acts: the republished and subsequently

amended Company Law number 31/1990 and the Government Emergency Ordinance number 44/2008 regarding the economic activities of the Sole traders, Individual enterprises and Family enterprises.

The Company Law number 31/1990 allows companies to choose between one of the five types of business entities that can operate in Romania: General partnership (in Romanian SNC), Limited partnership (in Romanian SCS), Limited partnerships by shares (in Romanian SCA), Joint stock company (in Romanian S.A.) and Limited liability company (in Romanian S.R.L.).

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### **The selection of an appropriate type of business entity according to the business features**

Each stage that the future entrepreneur has to follow is extremely important and has an essential contribution to the future business success.

In this paper we propose to present and make an analysis of the key elements that future entrepreneurs must think of and that need to be correlated with the business particularities for finally choosing the most appropriate form of licensing the business.

We believe that the best decision on a business authorization form may be taken by the entrepreneur after analyzing its business following features:

- the activity that will be organized;
- the size of business and its future development opportunities;
- the future number of business partners;
- the involvement and responsibility level assumed by business partners;
- the available capital correlated with the needed one;
- the future tax liabilities;
- the specific characteristics of each legal form stipulated by the law.

#### **1. The activity that will be organized**

Not every activity can be organized in a legal form. The two major laws governing the licensing of a business provide full information for the entrepreneurs regarding the activities that can form the business domain for a business entity or Sole traders, Individual enterprises and Family enterprises.

#### **2. The size of business and its future development opportunities**

According to the estimates on the size of business, on its future development opportunities, entrepreneurs can choose a simple form of licensing (GEO 44/2008 on economic activities of the Sole traders, Individual enterprises and Family enterprises) when the business is small and has no future development possibilities. In this case, the licensing as a Sole trader is recommended for those that are working alone and are unable to hire more staff. An Individual enterprise offers the opportunity to work with staff, while a Family enterprise operates only with family members. In order to establish a big business, with future development opportunities, it is better to opt for one of the types stated by the republished Company Law 31/1990.

#### **3. The future number of business partners**

Depending on the number of business partners, entrepreneurs may opt for different types of businesses. If the business will have a single partner then the only legal form that can be used is the Limited liability company. If however the number of partners or shareholders willing to join in order to form a business is more than 50, then they cannot authorize as a Limited company. Generally, an entrepreneur decides to license as a business entity when he has at least one associate.

#### **4. The involvement and responsibility level assumed by business partners**

There are significant differences between the presented types of business entities that can operate in our country in terms of degree of involvement and responsibility assumed by the partners. Thus, in a Limited liability company each partner has a limited liability correlated with his contribution to the capital. Not the same thing happens with the administrator.

The administrator's liability can be grouped into three categories:

- Ordinary liability to the company and associates;
- An outstanding liability to third parties;
- Aggravated liability in case of bankruptcy of the company.

For a General partnership (SNC) the social obligations are guaranteed with the social patrimony and unlimited joint liability of all partners. Within Limited partnership (SCS) and Limited partnership by shares (SCA) the limited partners respond with all their wealth while the general partners respond according to their contribution to the share capital (SCS) or they pay shares (SCA).

#### **5. The available capital correlated with the needed one**

Currently the limit provided by law for share capital is relatively low. We refer to the 200 RON, the minimum for Limited liability companies. Certainly for starting a business, much larger resources are needed, depending on what the new business is intended to achieve. There are different possibilities for authorization of economic activities stipulated in the GEO 44/2008 on economic activities of the Sole traders, Individual enterprises and Family enterprises where share capital is not required. The Company Law 31/1990 also offers the possibility of an authorization without capital in the case of the General partnership (SNC). For this type of business the law does not require and does not set a minimum capital. Partners are free to determine, after their own interests, the value of the social capital. General partnership, Limited partnership and Limited liability companies are obliged to pay fully the share capital, on its constitution date.

The highest minimum capital required by law is to establish a Joint stock company (S.A.) or a Limited partnership by shares (S.C.A) than cannot be less than 90.000 RON. The Government may change the minimum capital at most once every two years, taking into account the exchange rate so that the amount in RON be equivalent of 25.000 EUR. At the constitution the share capital, paid by each shareholder cannot be less than 30% of the subscribed one, unless the law provides otherwise. The remaining capital will be paid within 12 months from registration.

#### **6. The future tax liabilities**

A very important element in choosing a legal form of licensing relates to the future tax liabilities that the entrepreneur should pay.

As shown in the Tax Code Law, Law number 571/2003 updated by the GEO 125/2011 and valid in 2012, the tax system for business entities are different than the tax systems for Sole traders, Individual enterprises and Family enterprises. Thus, companies can be taxed at profit tax or income tax on small enterprises if they meet certain conditions prescribed by law.

Profit tax is the amount of 16% and applies to taxable gross profit. Gross profit is determined as the difference between the total taxable income and the total expenses contributed to the income adding deductible expenses.

Micro income tax is the amount of 3% and applies to gross income of a business entity that is called microenterprise. To do this, that business shall cumulative meet on the 31th December of the previous fiscal year, the following conditions:

- To have other revenues than those referred to in art. 112 ^ 2. (6);
- To have from 1 up to 9 employees;
- To have achieved revenues that did not exceed the equivalent of 100.000 EUR;

- Its capital to be held by persons other than the state and local authorities.

According to art. 112 ^ 2. (6), from the Tax Code Law, cannot choose to pay income tax on micro, Romanian legal entities which:

"a) are engaged in banking activities;

b) are engaged in the insurance and reinsurance, capital market areas, except for legal persons conducting brokerage activities in these areas;

c) are engaged in activities in the field of gambling, and management consulting;

d) have the share capital held by a legal shareholder or associated person with over 250 employees."

Depending on the estimated revenue and expenditure on the share of gross profit in the turnover and on the fact that the business entity qualifies to pay income tax for micro, entrepreneurs can opt for a taxation system or another. For example, if the gross profit share in total business turnover is low, the profit tax system is recommended. In this category we include businesses in the wholesale trade or retail.

If a business has a high percentage of gross profit in total turnover and it is not a business in the management consulting area, the income tax for micro is recommended. For example, for a real estate agency this tax system is more advantageous than the profit tax one. Under no circumstances businesses that have low return rates should choose this type of system. For the three forms of licensing governed by GEO 44/2008 is likely to pay tax on income from independent activities but is determined differently than the one for micro.

For Sole traders, Individual enterprises and Family enterprises the tax on income from independent activities does not reflect the correct method of calculating the payable tax. In fact, income tax is determined as a profit tax. The tax rate is the same, 16% and the base to which this percentage is applied is determined as the difference between total revenues (collected) and total expenditures for these revenues, adding additional deductible expenses.

Sole traders, Individual enterprises and Family enterprises have also the possibility to choose between two tax systems: tax on income from independent activities in real system, determined on the information from the simple base accounting and annual net income tax based on income norms.

General directions of territorial public finance shall:

- Set the roster, for which net income is determined based on income norms;

- Set the level of income standards;

- Public annually, during the fourth quarter of the preceding year to be applied.

Income norms for each employed person that generates commercial revenue cannot be less than the minimum gross salary at the time of its determination, multiplied by 12. Taxpayers engaged in activities for which the net income is determined based on income norms are not required to organize and conduct simple bookkeeping task.

The future entrepreneur is the one deciding between the two tax systems, the one based on income norms or the real system one.

Future tax liabilities may also refer to the option of paying or not the VAT (value added tax). For a turnover that exceeds 65.000 EURO, taxpayers are required to pay VAT. Up to this limit it is possible to be non-taxable. Considering that the VAT rate is currently very high (24%), the decision to opt for non-taxable business is extremely important for future entrepreneurs. Small businesses are selling their products directly to the consumer so it is advisable to not register as a VAT payer, if they are not exceeding the 65.000 EUR limit. This recommendation is also valid for businesses that do not require large initial investment in machinery and equipment.

If the products or services of a business are primarily addressed to other businesses, it is advisable to register as a VAT payer by choice, right from the start up. If in order to get started the business needs major investments in acquisitions (tools, machinery, furniture and so on) the entrepreneur should register for VAT by choice, even if the turnover is less than 65.000 EUR.

This will allow the VAT deduction from the purchase prices of the investments that are made. For example, for a real estate agency, that does not require large investments and provides its services mainly to consumers, the VAT registration is not recommended until the 65.000 EUR turnover is reached.

If the entrepreneur desires to establish a production unit for textile, where investments are needed in order to build space for its arrangement, for the purchase of machinery, sewing machines, cutting, ironing and so on, and the products are sold to other companies that are paying VAT, we recommend registering for VAT from the start up.

## **7. The specific characteristics of each legal form stipulated by the law, other than those outlined above.**

### **Conclusions**

The decision to choose a particular type of business licensing can be based on other issues such as the authorization costs of the business, the complexity and difficulty of the licensing, the business administration costs, business funding opportunities, development opportunities etc.

Comparing companies that may be authorized in accordance with Law 31/1990 and Sole traders, Individual enterprises and Family enterprises, authorization forms regulated by GEO 44/2008, we can identify several advantages and disadvantages.

The advantages of licensing under a certain type of company governed by Law 31/1990 are:

- Greater opportunities for business development;
- Greater opportunities for business financing. Projects providing guarantee for SMEs to have better access to credit;
- Higher tax breaks. Most government programs that support entrepreneurship and increase the number of SMEs concern companies. The introduction of micro income tax in 2001 is only applicable to companies that meet certain conditions;
- There is no limit for the number of employees, unlike in the case of Sole traders, where the entrepreneur is the only one allowed to work, or in the case of Family enterprises where only family members are allowed to work.

The disadvantages are:

- The authorization procedure takes longer and it's more complicated;
- License fees are higher;
- The accounting system is more complicated - double entry bookkeeping for businesses and the simple bookkeeping for Sole traders, Individual enterprises and Family enterprises or even lack of any records, when opting for annual income tax based on income norms;
- Higher costs for the bookkeeping. For signing the annual financial statements, balance sheet and profit and loss account, a company must pay a qualified person - chartered accountant, an auditor or an accountant who is a member of CECCAR (Body of Accountants and Licensed Accountants of Romania). For a single entry accounting, and for preparing the "Register of receipts and payments" and other specific documents needed, the contractor can hire anybody, without high qualification. Total costs can be even eliminated when Sole traders, Individual enterprises and Family enterprises choose for the annual income tax based on income norms.

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