TAXATION OF PERSONAL INCOMES IN ROMANIA: PRESENT AND PERSPECTIVES

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***Abstract**: The personal income tax is not only as an important revenue instrument but also as an instrument of national policy. Taxation of personal income in European Union countries is regulated usually by a progressive rate structure. This article aims to highlight the differences between Romania and other EU member states in the field of personal income tax and to raise the issue of reforming the tax system by introducing the tax household.*

Keywords: Household tax, Personal income tax, Tax system.

JEL Classification Codes: H24, H31.

1. INTRODUCTION

The structure of taxation system influences many aspects of economic and social life. Tax rate cuts may encourage individuals to work, save, and invest, but if the tax cuts are not financed by immediate spending cuts, they will likely also result in an increased federal budget deficit, which in the long-term will reduce national saving and raise interest rates (Gale and Samwick, 2014).

Taxation systems for the incomes obtained by individuals are characterised by significant peculiarities from one country to another, both from the point of view of the tax rates, as well as from the point of view of the manner of determining the tax base. Taxation systems for the incomes obtained by individuals generally incorporate mechanisms that ensure the compliance with the principle of fiscal equity, according to which the tax burden of each taxpayer must be set based on the contributory power of each taxpayer, or the size of the taxpayer's income or the property, respectively (Pirvu et al. 2016).

The personal income taxation can be made based on: (a) the incremental tax rates that ensure differentiated taxation depending on a certain number of thresholds; the progressive tax system enables the state to decrease the incidence of taxes on persons with low incomes and is deemed more equitable or (b) the proportional tax rates that remain unchanged, regardless of the changes occurred in the taxation base; the taxation system based on proportional rates is a generator of social inequity, but benefits from the advantage of simplicity.

According to Văcărel et al. (2007), in the international taxation practice two taxation systems of the personal incomes were formulated: (a) the separate taxation system that can be met either in the form of a single tax on income, which allows, however, for a differentiated taxation for each income category, or by the establishment of several taxes related to each part of the income obtained from a certain source and (b) the overall tax system that implies cumulating all incomes earned by an individual, regardless of source and taxing the cumulated income by a single tax. Personal income taxation system creates the prerequisites for social justice through different income tax rates, in a progressive tax system, but a crucial role is played by the size of tax-exempt amount (Bikas et al., 2014).

The personal income tax is easier to change when the taxpayer's ability to pay taxes is affected by various life-course circumstances (such as the number of dependents the taxpayer supports or extraordinary medical expenses).

In many countries, the personal income tax is viewed as the primary instrument for redistributing income and wealth (Zolt and Bird, 2005). The International Monetary Fund reveal differences between the industrial countries and developing countries in personal income tax, in the sophistication of the tax administration, and in the political power of the richest segment of the population are the primary contributors to this disparity (Tanzi and Zee, 2001).

The systems of personal income taxes in the European Union member countries are characterised by diversity both in terms of tax rates (certain new member states use proportional tax rates, while other states use progressive tax rates based on a different number of thresholds), and in terms of the method of determining the taxation base. The fiscal reforms completed in the past few years in the European Union member countries have generated, especially in the field of labour taxation, the decrease in the tax burden. Many of the measures implemented in order to reduce the tax burden on labour were focused on certain socio-professional groups.

The system of personal income taxes in Romania is simple and inexpensive, but does not allow for protection through taxation of the persons with low contributory capacity. From 2005, the 16% flat tax replaced the progressive tax rate system with four tax brackets (between 18% and 40%). The members of the Romanian Government wish to reform the system of personal income taxation by implementing certain measures meant to bring it closer to the personal income taxation systems in the developed countries in the European Union. The draft project that will bring crucial changes to the personal income taxation in Romania generated much controversy among specialists and politicians, the main question being: are there sufficient reasons (motivations) to replace a simple and easily managed system with an intricate one which will be complicated to implement?

2. COMPARATIVE ASPECTS CONCERNING THE PERSONAL INCOME TAXATION

Most member states of the Organization for Economic Cooperation and Development use personal income tax systems based on progressive tax rates (table 1).

Table 1. The Personal Income Tax Rate, in some countries (2017)

Country	Type of tax system	Tax rates	Number of thresholds
Greece	progressive	between 22% and 45%	4
France	progressive	between 0% and 45%	5
Italy	progressive	between 23% and 43%	5
Hungary	proportional	15%	-
United Kingdom	progressive	between 20% and 45%	3
Germany	progressive	between 0% and 45%	5
Letonia	proportional	23%	-
Spain	progressive	between 9.5% and 22.5%	5

Japan	progressive	between 5% and 45%	7
Poland	progressive	18% and 32%	2
Slovak Republic	progressive	19% and 25%	2
Slovenia	progressive	between 16% and 50%	3
Czech Republic	proportional	15%	-
Finlanda	progressive	between 0% and 31.75%	6
Belgia	progressive	between 25% and 50%	5
Austria	progressive	between 0% and 55%	7
Canada	progressive	between 15% and 33%	4
U.S.A.	progressive	between 10% and 39,6%	7
Korea	progressive	between 24% and 38%	3
Mexico	progressive	between 1.92% and 35%	11

Source: Tax Database, Organization for Economic Cooperation and Development

In these countries, the progressiveness of taxes on incomes plays a significant role in achieving a more equitable redistribution of incomes before taxation, compared with the case in which the redistribution is made after the taxation of incomes (Paturot et al., 2013).

In the member countries of the Organization for Economic Co-operation and Development, taxes on incomes from labour represent the most important component of the personal income tax, and have an important contribution to the determination of the establishment of tax revenue. In such context, even if tax rates for incomes earned by individuals have decreased lately, high taxes on workers can frequently be seen in certain states (Torres et al., 2012).

At European Union level, the personal income taxes have many peculiarities, varying from one country to another, as can be seen in Table no. 2. Thus, in order to protect the incomes of persons who have dependants or earn low incomes, the tax regulations in certain states provide for the possibility of decreasing the taxable income by certain amounts named basic deductions. Individual from certain countries may also benefit from tax credits[1], especially for the incomes earned abroad, or for the possibility of taxing the family incomes. Other tax facilities may be related to professional expenses, mortgage payments, contributions to pension funds, etc. Certain European Union member countries charge extra taxes at central or local/regional level, for the incomes earned by individuals.

Table 2. Characteristics of personal income tax in the European Union member countries

The existence of an extra tax (at local level, solidarity tax, etc.)	**Important basic deduction**	**A high number of other deductions/tax credits** (professional expenses; mortgage payments; contributions to pension funds; childcare expenses; educational expenses; donations; expenses for purchasing ecological or energy-efficient products, etc.)
Belgium, Croatia, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, Portugal, Spain, Sweden	Austria, Belgium, Cyprus, Denmark, Luxemburg, Malta, Sweden, Great Britain	Austria, Belgium, Czech Republic, Finland, France, Greece, Italy, Latvia, Lithuania, Luxemburg, Malta, the Netherlands, Poland, Portugal, Slovenia, Spain, Sweden, Great Britain

Source: Drafted by the authors based on the Taxation trends in the European Union (2016), European Commission.

[1] According to the Romanian Fiscal Code, the tax credit is a decrease of the income tax by the amount of the tax paid abroad.

According to Skrzypek-Ahmed and Woowiec (2015) the various tax exemptions, tax credits and deductions allowed erode the taxation base. Tax credits and deductions allowed are not only different in the member countries, but they are also fluctuating due to the changes in the social and economic environment, government preferences, business cycle phase, etc. The EU member countries take into account the taxpayer's capacity to pay taxes. Income taxation systems for individuals usually aim at supporting taxpayers who are married and/or have children.

European countries with a high level of personal income tax (for example France and Germany) are characterised by high levels of redistribution of the incomes. The new member countries (especially those in the southern part of the EU) promote policies in the field of direct taxation that tend to be relatively less redistributive (Avram et al., 2014).

The public revenues from the taxes on personal income, as share of the GDP, recorded, in certain European Union member countries, a downtrend in the past few years, and an uptrend in other countries (figure 1). The proceeds from the tax on the income earned by individuals have a significant contribution to the establishment of public financial funds in certain countries (for example, Denmark), while in countries such as Bulgaria, Romania or Slovakia the importance of such proceeds is much lower.

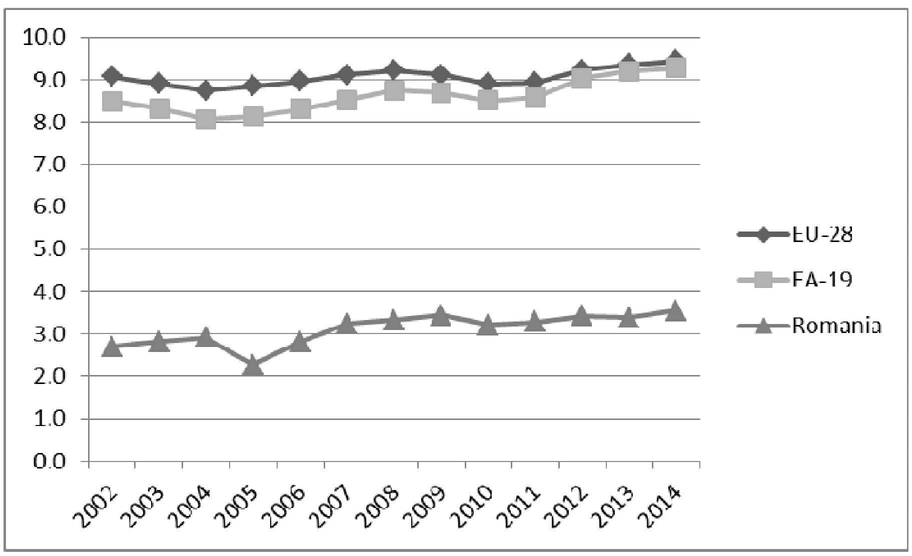

Figure 1. The public revenues from the taxes on personal income, as % of the GDP, în European Union Member States

Source: Drafted by the authors on the Data on taxation, European Commission

The amount of the public revenues from the personal income taxes depends, to a great extent, on the level of the tax rates applied at the level of the European Union member countries. Thus, in Western European countries, the highest levels of tax rates applied to personal incomes are recorded (for example, tax rates of more than 55% are applied in Sweden and Denmark) unlike the Eastern European countries (for example, in Bulgaria, the tax rate for incomes earned by individuals is 10%).

Taxes on personal income in EU member states have not been harmonized even when the European Union achieves a higher level of integration. The European Commission believes that taxes on personal income are a matter for the Member States to determine. At the same time, in some cases, the Commission acknowledges that co-ordination at EU level is necessary to safeguard the application of the Treaty freedoms and to eliminate tax obstacles to cross-border activities. There is also a need to co-ordinate personal income taxes to prevent double taxation, or unintentional non-taxation in cross-border situations, or to tackle cross-border tax evasion. The European Court of Justice has consistently held that, in the absence of harmonisation, taxes on personal income fall within the competence of the Member States but they must respect the fundamental EC Treaty principles on the four freedoms (free movement of workers, services and capital, and the freedom of establishment). In particular, there must be no discrimination on the basis of nationality (European Commission, 2006).

2. PERSONAL INCOME TAX IN ROMANIA

According to the provisions of the Fiscal Code, in Romania, the personal income tax is applicable to the following sources:

- Incomes from independent activities;
- Incomes from wages;
- Incomes from concession, lease, and rental of immovable property;
- Incomes from investments;
- Incomes from pensions;
- Incomes from agricultural, forestry and fish farming activities;
- Incomes from prizes and gambling;
- Incomes from the transfer of real property;
- Incomes from other sources.

According to the legal regulations, personal income tax is applied to persons residing in Romania (for incomes earned from any source, in the country or abroad) and non-residents who earn incomes from independent activities through permanent offices in Romania or dependent activities, or earn incomes for which they owe income tax.

Most categories of incomes obtained by individuals are taxed by the 16% flat tax rate. The taxable base is determined differently depending on the income source (table 3):

Table 3. Aspects concerning the personal income tax in Romania

Income category	Taxable base	Tax rate
Incomes from independent activities	Net income = gross income – deductible expenses	16%
Incomes from wages	Net income = incomes from wages and similar source – mandatory social contributions and contributions to private pension funds, within the limit of 400 eur/year – personal deduction – contribution to the trade union– Voluntary health insurance premiums, within the limit of 400 eur/year	16%
Incomes from concession, lease, and rental of immovable property	Net income = gross income – deduction of the 40% expense rate from the gross income	16%
Incomes from investments	-dividends; -interest; -earnings from the transfer of securities and other transactions with financial instruments; -earnings from the transfer of gold; -incomes from the liquidation of a legal entity.	5% 16% 16% 16% 16%
Incomes from pensions	Taxable income = income from pension –	16%

	individual contribution to health insurance – a non-taxable amount[2]	
Incomes from agricultural, forestry and fish farming activities	Net income = gross income – deductible expenses or The income established based on the annual income tax bracket	16%
Incomes from prizes and gambling	Net income = income from prizes – amount representing non-taxable income[3] and Gross income from gambling	16% From 1% to 25% depending on the size of the income
Incomes from the transfer of real property (upon the transfer of the ownership and its dismemberment, by legal documents between living persons in relation to buildings and land)	The value declared by the parties in the document by which the ownership is transferred, but not less than the minimum value determined through market research made by the chambers of notaries public	3% on the taxable income. The taxable income is determined by deducting from the value of the transaction the non-taxable amount of 450,000 RON

Source: European Commission, Taxation trends in the European Union, 2016

The exemption from the payment of the personal income tax is applied in the following cases:
- for incomes earned by persons with severe or accentuated disabilities, both from wages and independent activities;
- for incomes from wages earned for carrying out software development activities;
- for incomes from wages earned for carrying out applicative research and/or technical development activities.

A current legislative proposal of the Government aims at introducing the overall household tax. The household is a group comprising one of several related or non-related individuals who have common assets they manage together from the economic and financial point of view. The annual overall income will be determined at the level of each household as the sum of the incomes earned by each member of the household in Romania. According to this project, the annual taxable overall net income will be determined taking into account a higher number of deductions, compared to the current situation: the social security contribution and the contribution to the social health insurance fund; voluntary health insurance premiums, and medical services provided in the form of subscriptions (capped at certain amounts); contributions to facultative pension funds; voluntary health insurance premiums; mandatory car and house insurance; educational and recreational programmes for dependent children (private kindergartens, before-/after-school programmes, school fees, summer camps and school trips, courses: foreign languages, arts, sports, tutoring courses); supplying the account for permanent education; educational activities for young people/adults (e.g. school taxes, etc.); sports activities for adults (e.g. fitness, gym or dance subscriptions, other sports activities); purchasing books and stationery products; cultural activities (e.g.: theatre and cinema tickets/subscriptions, shows);

[2] According to the provisions of the Fiscal Code, aplicable as at 1 January, 2017, the monthly non-taxable amount is 1,100 RON.

[3] According to the provisions of the Fiscal Code, aplicable as at 1 January 2016, prizes with a value lower than 600 RON are not taxable.

balneary, physiotherapeutic, kinetotherapeutic services; drugs for chronical and severe diseases; household maintenance and repairs; supporting non-profit entities established and operating in compliance with the law, religious units, and granting private scholarships, in compliance with the law.

If the net annual taxable overall net income is negative, each child in the household will be allocated the amount of 1,200 RON/year.

The annual overall household income tax would be calculated by applying the 10% tax rate on the annual taxable overall income, if the value of the latter exceeds 24,000 RON/year. Consequently, several withholding taxes (among which, the most important, i.e. the tax on the incomes from wages) would be paid once a year, o directly by the taxable subjects (employees).

The activities of calculating the annual income owed by each household, and of filling in the overall income statement for the members of the household, based on supporting documents supplied by the representative of the household, would be carried out by tax consultants, paid from public funds.

4. CONCLUSIONS

The legislative project for the introduction of the tax on the annual overall household income in Romania is the first attempt of defining, from the fiscal point of view, concepts existing in the fiscal legislations of other European countries and may be the starting point for the reintroduction of the progressive tax system.

In accordance with the government programme of the party that won the elections, the income tax rate will be reduced from 16% to 10%, contributing to the increase in the purchasing power of individuals (of the consumption) by decreasing taxation Another estimated effect of the changes in the income taxation system for individuals would be a significant reduction of tax evasion and black economy, because taxpayers would be interested in receiving receipts for the goods/services benefiting from deductions, with a corresponding increase in the revenue to the government budget. Important social and economic sectors (education, health, insurances, constructions, etc.) will be stimulated.

The introduction of the new personal income tax system generated many contradictory debates. According to certain opinions, this is just a mask for testing the overall income tax with progressive brackets, extremely useful when the Romanian economy will enter a declining phase (in such context, mention should be made of the preference of the Romanian members of the government for procyclical policies). The increase in bureaucracy and administrative expenses would be other weaknesses of the new system, and consequently, there are specialists who deem that the effort and risks of introducing this new tax system are disproportionate (higher) than the generated benefits.

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