

The profit tax versus the income tax for microenterprises

Cucoşel C.¹

¹ North University of Baia Mare, Faculty of Science, costin.contab@xnet.ro

Abstract. As specified in the preface of the European Chart for Small Enterprises, the small companies are the foundation of the European economy. They represent an essential source of jobs and new business ideas. The efforts of the European Union to form a new economy will have success only if the small enterprises will be the priority of its work agenda. These enterprises are the most sensitive companies to changes in the business environment. They are the first to be affected by the burden of bureaucratic excesses. Also, they are the first to flourish from the initiatives to eliminate bureaucracy and reward success. The existing 23 million small and medium sized enterprises (SMEs) in the European Union ensure 75 million places of work and represent 99% of all the companies. This is why supporting the SMEs is one of the priorities of the European Commission in order to achieve economic growth, to create new jobs and attain social and economic cohesion.

Keywords: microenterprise, income tax, minimum tax, turnover

1 Introduction

17

The special attention of the Romanian Government for the development of the small and medium sized enterprises led to introducing the income tax for microenterprises as an alternative to the income tax.

The income tax for microenterprises was introduced for the first time in Romania in 2001 once the Government adopted the Ordinance no. 24/2001.

Presently the income tax of the microenterprises is stipulated in the Title IV (art. 102-112) from the Fiscal Code and Methodological Standards applying for title IV from the Fiscal Code (Point 1-17).

From an economic point of view, the microenterprise is defined by the art. 4, paragraph (1), letter a) from Law no. 346/2004 as a small or medium sized enterprise with “no more than 9 employees and a net annual turnover or owning a total amount of assets of up to 2 million euro, or its equivalent in lei”.

From a fiscal point of view, the microenterprise is defined by art. 103 from the Fiscal Code as a Romanian legal entity that fulfills all of the following requirements at the 31st of December of the previous fiscal year:

- a) It has other source of income than the one obtained from consulting and management that constitutes more than 50% of the total income;
- b) It has 1 up to 9 employees;
- c) It achieved an income that did not exceed the equivalent in lei of 100.000 euro;
- d) The registered capital of the legal entity is owned by persons, others than the state, local authorities and public institutions.

It is important to point out that, from an economic point of view, the notion of “microenterprise” is much larger than from a fiscal point of view.

The judicial doctrine operates with the idea that there is a lack of legal correspondence concerning the definition of the notion “microenterprise”. My opinion is that this problem is false because the fiscal legislator didn’t want this tax to apply to all the legal entities that fulfill the condition of being microenterprises, as per the general law.

2 The Characteristics of the Profit Tax and Income Tax for Microenterprises

In that which follows, this paper will present the main characteristics of the profit tax and income tax for microenterprises based on the tax element, in order to emphasize the similarities and the differences between them, namely:

- The subject of tax or taxpayer;
- The area the tax applies to;
- The fiscal year;
- The tax rate;
- The tax base;
- Paying the taxes and submitting the tax return.

2.1 The taxpayers

The profit tax	The income tax for microenterprises
<ul style="list-style-type: none"> • Romanian legal entities; • Foreign legal entities that carry out their activity through a permanent office located in Romania; • Foreign nonresident legal entities and physical persons that carry out their activity in Romania in partnership and don’t have a legal personality; • The foreign legal entities that have an income from/or related to real-estate properties located in Romania or from selling/granting shareholder titles owned by a Romanian legal entity; • The resident physical persons in partnership with Romanian legal entities, both for the income earned in Romania and abroad from partnerships without legal personality; in this case, the due tax is calculated, deducted and paid by the Romanian legal entity. 	<p>The income tax for microenterprises is optional and not compulsory.</p> <p>The microenterprises that pay a profit tax can opt for the tax stipulated in title IV from the Fiscal Code, starting with the following year, if:</p> <ul style="list-style-type: none"> • They meet all the conditions stipulated by art. 103 from the Fiscal Code; • They never paid the income tax for microenterprises before. <p>A newly founded Romanian legal entity can chose to pay the income tax for microenterprises starting with the first fiscal year, if:</p> <ul style="list-style-type: none"> • It meets all the conditions stipulated by art. 103 letter a) and d) at the date it is recorded in the Trade Register; • The condition stipulated by art. 103., letter b) is complied with within 60 days from the registration date.
<p>Tax-free legal entities:</p> <ul style="list-style-type: none"> • The State Treasury; 	<p>The Romanian legal entities that carry out their activity in the areas below cannot choose this</p>

<ul style="list-style-type: none"> • Public institutions; • The Romanian legal entities that pay the income tax for microenterprises; • Romanian foundations; • Religious institutions; • Private accredited educational establishments; • Owner associations. 	<p>taxation system:</p> <ul style="list-style-type: none"> • Banking; • Insurance and reinsurance, capital market except the legal entities that carry out mediating activities in these areas; • Gambling, sport betting and casinos; • If they have a registered capital owned by a shareholder or partner that is a legal entity with more than 250 employees.
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2.2 The Area the Tax applies to

The profit tax	The income tax for microenterprises
<ul style="list-style-type: none"> • In the case of Romanian legal entities, the profit tax is applied on the profit subjected to tax obtained from any source both in Romania, and from abroad; • In the case of foreign legal entities that carry out their activity through a permanent office located in Romania, the tax is applied on the taxable profit associated with the permanent office; • In the case of the foreign legal entities and nonresident physical persons that carry out their activity in Romania in a partnership without legal personality, the tax is applied on the levied share of profit associated with every person; • In the case of the foreign legal entities that have an income from/or related to real-estate properties located in Romania or from selling/granting shareholder titles owned by a Romanian legal entity, the tax is applied on the taxable profit associated with this income. 	<p>According to art. 105 from the Fiscal Code, the tax stipulated by the title IV, called the income tax for microenterprises is applied only on the income obtained by the microenterprises from any source, except the ones stipulated in art. 108 from Law 571/2003 with subsequent modifications and completions.</p>

2.3 The Fiscal Year

The profit tax	The income tax for microenterprises
<p>The fiscal year is the calendar year. When a taxpayer is set up or ceases its existence during a year, the period subjected to tax is the period of the calendar year the taxpayer existed.</p>	<p>According to art. 106 from Law no. 571/2003, the fiscal year of a microenterprise is the calendar year. In the case of a legal entity that is set up or</p>

	<p>suspends its existence, the period levied upon is the period of the calendar year when it existed. The Government Order no 44/2004 on the Methodological Standards of applying the Fiscal Code stipulates the following:</p> <p>1) When a microenterprise is set up during a fiscal year, the taxable period begins:</p> <ul style="list-style-type: none"> ✓ One the date it was recorded in the Trade Registry, if it has such an obligation. <p>2) When a microenterprise is liquidated during a fiscal year, the period subjected to tax ends on the day the company is erased from the registry where it was recorded.</p>
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2.4 The Tax Rates

The profit tax	The income tax for microenterprises
The profit tax rate applied to the taxable profit is 16%, except the cases stipulated in art. 38 from the Fiscal Code.	According to art. 107 from the Fiscal Code, modified by Law no. 343/2006, the tax rate from the income tax of microenterprises is: 2.5% for 2008 and 3% for 2009.

2.5 The Tax Base

The profit tax	The income tax for microenterprises
The taxable profit is calculated as the difference between the income obtained from any source and the expenses made in order to achieve income during a fiscal year, deducting the tax-free income and adding the nondeductible expenses.	The tax base of the income tax for microenterprises is formed by the income earned from any source, subtracting the nondeductible income.
<p>The tax-free income:</p> <ul style="list-style-type: none"> ▪ The dividends received from a Romanian legal entity ▪ The positive differences in value of shareholder titles registered after incorporating reserves, benefits or share premiums to legal entities that own shareholder titles, as well as the differences in value of long-term investments as owned shares in partner companies, shareholder titles and investments as fixed assets, recorded according to the accounting regulations. 	<p>The tax-free income:</p> <ul style="list-style-type: none"> ▪ The income from stock variations; ▪ The income earned by producing tangible and intangible assets ▪ The income earned from exploitation that represents the share of government subsidies and other resource used for financing investments; ▪ The income earned from provisions; ▪ The income generated by cancelling the debts and the penalties to be paid to the state budget, that were nondeductible expenses when calculating the profit

<ul style="list-style-type: none"> ▪ The income generated after cancelling the nondeductible expenses; ▪ The income generated from decreasing or cancelling the nondeductible provisions; ▪ The income obtained by recovering nondeductible expenses; ▪ Tax-free income stipulated as exemptions in agreements and memorandums approved by the regulations; <p>In the period of time between the 1st of January 2009 and 31st of December 2009, including the 31st, the income generated from transacting shareholder titles on the authorized market supervised by the National Securities Commission.</p>	<p>subjected to tax, according to the legislation;</p> <ul style="list-style-type: none"> ▪ The income earned from indemnities paid by the insurance companies for damages caused to tangible assets owned by the microenterprise. <p>The following are not subject to taxation when calculating the income tax to be paid by the microenterprises that stop their existence as a result of partition, dissolution or liquidation:</p> <ul style="list-style-type: none"> ✓ The reserves formed by the net profit; ✓ The reserves formed by the positive differences of the exchange rate associated to the registered capital into currency or available currency;
<p>The profit tax</p>	<p>The income tax for microenterprises</p>
<p>Nondeductible expenses:</p> <ul style="list-style-type: none"> • Taxpayer’s own expenses related to the profit tax to be paid; • The interest rates/ late charges, fines, sequestrations and penalties; • The expenses related to the nature of stored goods or the tangible assets that are damaged or missing; • The expenses registered by the bookkeeper that are not backed up by appropriate documents; • The expenses related to tax-free income; • The expenses related to insurance that are not associated with the assets of the taxpayer. • Limited deductibility expenses • protocol expenses within the limit of 2% of the difference between total taxable income and total expenses related to the taxable income, other than protocol expenses and profit tax expense; • reimbursement of travel allowances for the employees traveling in Romania and abroad, within the limit of 2.5 times the legal level established for public institutions; 	<p>The G.O. no. 44/2004 on the Methodological Standards of applying the Fiscal Code stipulates the following:</p> <ul style="list-style-type: none"> • The microenterprises that pay the income tax organize and manage their bookkeeping according to Simplified accounting regulations, synchronized with the European directives; • The positive differences of the exchange rates resulted after evaluating the outstanding debts and the debts into foreign currency existing at the 31st of December, registered by the bookkeeping into account 117 "Reported result" is considered to be an income subjected to tax as these outstanding debts are settled and the debts are paid; • In case if a microenterprise purchases cash registers, their purchase value is deducted from the tax base according to the justifying act for the trimester the registers started to be operated, according to the legislation.

<ul style="list-style-type: none"> • Sponsorship and/or patronage expenses and the expenses related to private scholarships awarded according to the legislations provided that: <ul style="list-style-type: none"> ✓ They are limited to 3 to a thousand from the turnover; ✓ They do not exceed 20% from the profit tax to be paid. 	
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2.6 Paying the taxes and submitting the tax return

The profit tax	The income tax for microenterprises
<p>The taxpayers are obliged to submit an annual income tax return until the 15th of April, including the 15th, of the next year; they are responsible for calculating the profit tax.</p>	<p>The microenterprises have the obligation to submit the income tax return by respecting the deadline for tax payment.</p>
<p>According to art. 34 from the Fiscal Code, the payment is done as following:</p> <p>a) The taxpayers, banking institutions, Romanian legal entities, the Romanian branch offices of the banks, foreign legal entities must pay an annual profit tax, submitting each trimester advance payments that are synchronized with the inflation index (December as compared to the month of December of the last year), estimated when elaborating the annual initial budget for which advance payments are made. The deadline for paying the annual tax is the deadline for submitting the income tax return, namely the 15th of April, including 15, of the next year;</p> <p>b) The taxpayers, other than the ones mentioned at letter a) have the obligation to submit and pay the profit tax each trimester until the 25th of the first month following the trimester for which they calculated the tax. Starting with 2010, these taxpayers will apply the system of advance payments designed for the taxpayers stipulated at letter a).</p>	<p>The income tax for microenterprises is calculated and paid each trimester until the 25th of the month following the trimester for which the tax is calculated.</p>

3 Differences and Similarities between the Profit Tax and the Income Tax for Microenterprises

The following conclusion may be made after drawing a parallel between the profit tax and the income tax for microenterprises and by analyzing the information provided by this association:

3.1 Similarities

- Both of them are direct, permanent taxes applied on the taxpayers' income with the purpose to generate income at the state budget;
- The tax return is submitted each trimester, the same is valid for the payment that has to be made until the 25th of the next month;
- The fiscal year is the calendar year. In the case of a legal entity that is set up or ceases its existence during a year, the period subjected to tax is the period of the calendar year the taxpayer existed.

3.2 Differences

- The income tax for microenterprises is optional. Whenever a microenterprise decides to pay the profit tax, it cannot return to the previous tax system any longer, the decision being permanent even if the company meets the requirements in the following year,
- The calculation method of the tax rate for the profit tax is much more complex as compared to the one for the income tax for microenterprises, as it involves a larger number of regulations to be taken into account;
- The tax rates are different; the one applying to the companies that pay the profit tax is 16% from the tax base, while the microenterprises pay an income tax of 3% from the tax base.

4 Conclusion

The psychology of the taxpayer – amplified by the volume of fiscal pressure, the legal and administrative deficiencies when managing taxes – is to evade partially or totally the payment of its fiscal obligations. There are two types of tax systems for the activity of the trade companies – the profit tax and the income tax for microenterprises. The present paper has shown the way one could “juggle” with these two types of taxes, taking into account the present more and more restrictive legislation.

So, when is the income tax more convenient and when should the profit tax be applied?

In order to answer this question as accurately as possible, in that which follows, this paper will present a calculation for the **profit earned (p) by a legal entity** as an example of a case when it is more profitable for it to switch from the income tax for microenterprises to the profit tax, even if the company meets the conditions required in order to benefit from the simplified tax regime.

In order to demonstrate this, both of the taxes have to have the same value, that is:

Income tax = profit tax

We know that: $\left\{ \begin{array}{l} \text{The income tax} = 2.5\% \times V \\ \text{The profit tax} = 16\% \times (V-C) \end{array} \right.$

Therefore $2.5\% \times V = 16\% \times (V-C)$ relation (1)

But $V = C + C \times p$, that is $V = C \times (1 + p)$ relation (2)

By introducing the relation (2) into relation (1), the result is:

$$2.5\% \times C \times (1 + p) = 16\% \times [C \times (1 + p) - C] \Leftrightarrow$$

$$\Leftrightarrow 2.5\% \times C + 2.5\% \times C \times p = 16\% \times (C + p \times C - C)$$

Equivalent to $2.5\% \times C = 13.5\% \times p \times C$.

So $p = 18.52\%$.

V – The income subjected to tax;

C – Deductible expenses;

p – The earned profit expressed as a percentage of the expenses.

In case if p is higher than 18.52%, it is more convenient for a taxpayer to opt for the income tax for microenterprises, therefore it's more profitable for the taxpayer to choose the profit tax if p is lower than the above mentioned percentage, a percentage that has to be adjusted to the specifics of every company and to the fact that some types of income are tax-free, while some categories of expenses are nondeductible or have a limited deductibility.

Generally speaking, the recommendation for the companies that earn a high income and low expenses is to opt for paying the income tax for microenterprises, while the companies that have the value of income close to the one of expenses, with a low gross profit, should pay the profit tax.

At the end of the fiscal year, each taxpayer should analyze the real situation and opt for the profit tax whenever it is no longer convenient for the company to pay the income tax of microenterprises, even if it still meets the specific conditions required in order to apply the simplified tax regime. The **option** can be submitted until the 31st of January of the next fiscal year for which the income tax of microenterprises is paid. **However, it is important to point out that the legal entity can no longer return to the previous situation, once it gave up to this status.**

The microenterprises that pay the profit tax can chose to pay the income tax for microenterprises starting with the next fiscal year if they meet the conditions stipulated by art. 103, if they have never paid this tax before.

A newly founded Romanian legal entity can choose to pay the income tax for microenterprises starting with the first fiscal year if they meet the stipulations of art. 103, letter a) and d) at the date when the company is recorded in the Trade Register, and if the condition stipulated by art. 103, letter b) is complied with during 60 days from the date of registry.

In conclusion, this paper will present the main advantages and disadvantages of the two tax categories that exist presently in Romania: the income tax for microenterprises and the profit tax.

A. The advantages and the disadvantages of the profit tax

Advantages	Disadvantages
1. This tax system has no advantage when it comes to the deadline of submitting the tax return and paying the due tax, both system taxes have the same requirements (the tax return has to be submitted each trimester, while the payment has to be made until the 25 th of the following month). 2. In case if the microenterprise pays the profit tax, it can choose to pay the income tax for microenterprises at the beginning of the following fiscal year, if at the end of the previous year it meets all the conditions stipulated in art. 103 from the Fiscal Code and it never paid this tax before.	1. In case if a microenterprise pays the profit tax, it doesn't have any longer the option to choose between paying the profit tax or the income tax. 2. There is no doubt that calculating the tax base and the profit tax is much more complex as there are more regulations to take into account as compared to the income tax for microenterprises.

B. The advantages and the disadvantages of the income tax for microenterprises

Advantages	Disadvantages
1. In case if a company pays the income tax, it can opt for the profit tax starting with the following fiscal year if it's present tax system is no longer convenient for the company; 2. This tax system favors the companies with a high profitability.	1. Whenever a company that pays the income tax for microenterprises decides to switch to paying the profit tax, it can no longer return to the former tax system, its decision being permanent even if during the next year it complies with all the requirements stipulated by the legislation. 2. The microenterprises that pay the income tax for microenterprises no longer apply this tax system starting with the fiscal year following the year they no longer meet one of the conditions stipulated by art. 103.

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