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EXAMINING THE RECENT CHANGES TO TAX AND SOCIAL SECURITY LEGISLATION IN ROMANIA

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Introduction

As of 1 January 2018 the Romanian government decided to shift nearly all employer social security contributions to employers. In order to offset the increase, the personal income tax was reduced from 16% to 10%, this tax including earnings from wages, independent activities, rents, investments, pensions, agricultural activities, awards and other income. For intellectual property income, the tax rate on advance payments is set by applying the 7% tax rate to gross income (previously it was 10%). The tax rate on income as final tax is 10%.

According to the Government Emergency Ordinance no. 79/2017[1], the total employer/employee social security contribution rate will decrease from 39.25% to 37.25%; the new employee social security contribution rate will be 35%, including a general 25% rate and a health insurance contribution of 10%.

The employer social security contributions will largely be eliminated. Employers will be subject only to a 2.25% labor insurance contribution. Employers may also be subject to additional pension contributions of 4% or 8% for employers subject to specific work conditions.

The so-called Romanian fiscal revolution also includes the increase of the minimum *gross* wage from 1,450 lei (about 310 euro) per month to 1,900 lei (about 407 euro) per month. In these conditions, the *net* minimum wage will increase from 1,065 lei to 1,162 lei.

[1] OUG no. 79/2017 for amending Law no. 227/2015 regarding the Fiscal Code was published in the Official Gazette no. 885/10.11.2017.

These changes entering into force from 1 January 2018 represent an increase of 31.03% as compared to the previous year 2017.

Before the implementation of the new fiscal measures, Romania had the seventh highest cost of the social insurance contributions among the countries of the European Economic Area (*The Romanian Journal*, July 17, 2017). Even considering the reduction of the cumulated rate of contributions from 39.25% to 37.25%, Romania remains in the group of countries with high social contributions.

This paper indents a critical examination of the recent modifications to tax and social security legislation in Romania, trying also to derive some future implications for the living standards and economic development of the country.

Comments and critical analysis

Before the “fiscal revolution”, the employer and the employee had to pay contributions for health, pension and unemployment (see Table 1), but at present the employee pays both his contribution and the employer’s contribution out of his gross wage. As a consequence, the employee’s net wage will be lower, so that employees will depend on their employers in raising the gross wage for confronting higher social security contributions. The government asserts that wages will increase as a result of the fiscal revolution as the income tax is now only 10%. However, this can be true only for the public sector, not necessarily for the private sector, where employers will find solutions corresponding to their own interest.

Paradoxically, transferring the social security contributions from employers to employees, even if proposed by a social-democratic government, is a measure of an ultra-liberal nature, which leaves the employer in the unique position in Europe of not contributing in no way whatsoever to the social security systems (retirement and unemployment) or healthcare.

Table 1: Social security rates in Romania before 2018

Insurance type	Employer	Employee
Social security insurance – pension (old age, invalidity, survivors)	15.8%-25.8% (capped) (depending on working conditions)	10.5% (capped)
	Cap: 5x Average Gross Earnings (as projected for the Annual State Social Insurance Budget) i.e., RON 12,075 (EUR 2,692), (for 2016 RON 13,405 (EUR 3,000)), multiplied by the number of employees.	Cap: 5x Average Gross Earnings (as projected for the Annual State Social Insurance Budget) i.e., RON 12,075 (EUR 2,692), (for 2016 RON 13,405 (EUR 3,000)) per each source of earnings
Health insurance	5.2% (uncapped)	5.5% (uncapped)
	As of 1 January 2017, the health insurance contribution will be capped at the same level as the pension contribution	As of 1 January 2017, the health insurance contribution will be capped at the same level as the pension contribution.
Unemployment insurance	0.5% (uncapped)	0.5% (uncapped)
Sick leave and sickness benefit insurance	0.85% (capped)	N/A
	Cap: 12x min. gross wage (RON 1,050/EUR 236) (for 2016 RON 1,360/EUR 280)) for each employee	
Accidents at work and occupational diseases insurance	0.15%-0.85% (uncapped) (depending on working conditions)	N/A
Salary payment guarantee fund	0.25% (uncapped)	N/A

Note: This table shows that Romania belongs to the countries which apply a maximum salary cap to employer and/or employee social security contributions.

Source: Deloitte (2017)

Anyway, business owners are making money in Romania not only by their exclusive means or merit, but also by climbing on the shoulders of society, a community on whose infrastructure and resources they rely to make profits. Nevertheless, a government which claims it is a social-democratic one exempts all business owners of any contribution of solidarity with the community they make profit in (*Bursa*, 9.11.2017). As a general rule, in Romania there was not a correspondence between the government political orientation and the respective fiscal measures. For example, the flat tax of 16% was adopted by a center-right alliance between the National Liberal Party and the Democratic Party, meanwhile, the progressive taxation on individual income, much higher than the flat tax, was supported by the left wing president Ion Iliescu and PSD (Social-Democratic Party).

Table 2:

DATA SUMMARY (ALL FIGURES IN EUROS)

Country	Real Gross Salary[2]	Employer Social Security	Gross Salary[3]	Income Tax	Employee Social Security	Take-home Pay (Net Income)	VAT Rate	Estimated VAT	Real Net Salary	Real Tax Rate	Tax Liberation Day 2017
Austria	56,942	13,458	43,484	7,761	7,879	27,844	20.0%	1,810	26,034	54.28%	18-Jul
Belgium	59,775	13,082	46,693	12,868	6,072	27,753	21.0%	1,894	25,858	56.74%	27-Jul
Bulgaria†[4]	6,256	970	5,286	458	705	4,123	20.0%	268	3,855	38.39%	21-May
Croatia[5]	14,768	2,167	12,601	1,147	2,520	8,934	25.0%	726	8,208	44.42%	12-Jun
Cyprus[6]	25,189	2,598	22,591	266	1,762	20,564	19.0%	1,270	19,294	23.40%	27-Mar
Czech Republic	15,763	4,000	11,764	1,445	1,294	9,024	21.0%	616	8,409	46.66%	20-Jun
Denmark	54,901	306	54,596	19,434	153	35,009	25.0%	2,844	32,165	41.41%	01-Jun
Estonia†	16,649	3,723	12,926	1,937	219	10,770	20.0%	700	10,070	39.51%	25-May
Finland	53,247	9,711	43,536	8,496	4,062	30,978	24.0%	2,416	28,562	46.36%	19-Jun
France	56,499	18,707	37,792	2,542	9,516	25,735	20.0%	1,673	24,062	57.41%	29-Jul
Germany	56,180	9,138	47,042	8,785	9,679	28,578	19.0%	1,765	26,813	52.27%	10-Jul
Greece	25,383	5,086	20,296	3,862	3,247	13,187	24.0%	1,029	12,159	52.10%	10-Jul
Hungary†	12,682	2,413	10,269	1,540	1,900	6,829	27.0%	599	6,230	50.88%	05-Jul
Ireland	38,593	3,746	34,847	4,992	1,394	28,461	23.0%	2,127	26,334	31.77%	26-Apr
Italy	39,880	9,170	30,710	6,990	2,914	20,806	22.0%	1,488	19,318	51.56%	08-Jul
Latvia†[7]	12,132	2,316	9,816	1,855	1,031	6,930	21.0%	473	6,457	46.77%	20-Jun
Lithuania†[8]	11,363	2,793	8,569	1,285	771	6,513	21.0%	444	6,068	46.60%	20-Jun
Luxembourg	63,836	8,273	55,563	8,699	6,837	40,027	17.0%	2,211	37,815	40.76%	29-May
Malta[9]	18,497	1,934	16,563	2,062	1,934	12,567	18.0%	735	11,832	36.03%	12-May
Netherlands	58,609	9,374	49,235	9,043	6,695	33,497	21.0%	2,286	31,211	46.75%	20-Jun
Poland	12,483	2,133	10,350	734	2,223	7,393	23.0%	553	6,840	45.20%	14-Jun
Portugal	21,384	4,104	17,280	2,512	1,901	12,867	23.0%	962	11,905	44.33%	11-Jun
Romania†[10]	8,368	1,590	6,779	906	1,118	4,755	19.0%	294	4,461	46.69%	20-Jun
Slovakia	14,353	3,737	10,616	1,024	1,423	8,170	20.0%	531	7,639	46.78%	20-Jun
Slovenia	21,024	2,916	18,109	1,377	4,002	12,730	22.0%	910	11,820	43.78%	09-Jun
Spain	34,111	7,851	26,259	3,838	1,667	20,754	21.0%	1,416	19,337	43.31%	08-Jun
Sweden	58,059	13,881	44,178	10,939	0	33,240	25.0%	2,701	30,539	47.40%	23-Jun
United Kingdom	47,066	4,687	42,379	5,770	3,933	32,677	20.0%	2,124	30,553	35.08%	09-May

All figures in euros. Flat tax countries are marked with a dagger (†).

2. Total cost of employment, social security contributions, personal income tax figures and net income calculated by EY. Other calculations by Institut économique Molinari.
3. Unless otherwise noted, Average Gross Salary figures are from OECD's *Taxing Wages* or Eurostat's *Annual gross earnings in industry and services*.
4. Average Gross Salary figure for Bulgaria from the national statistics office: http://www.nsi.bg
5. Average Gross Salary figure for Croatia from the national statistics office: http://www.dzs.hr
6. Average Gross Salary figure for Cyprus from the national statistics office: www.mof.gov.cy
7. Average Gross salary for Latvia from the national statistics office: http://csb.gov.lv
8. Average Gross salary for Lithuania from the national statistics office: http://osp.stat.gov.lt
9. Average Gross salary for Malta from the national statistics office: http://nso.gov.mt
10. Average Gross salary for Romania from the national statistics office: http://insse.ro

Tax calculations provided by EY

Source: Molinari Economic Institute (Paris), https://www.atlasnetwork.org/partners/global-directory/molinari-economic-institute-institut-economique-molinari

Romania is the first EU country where employers do not anymore contribute to the social security system. Table 2 demonstrates that all EU member states divide at present the social contributions between the employer and the employee and in most cases the contributions paid by employers are bigger.

Romanian president Klaus Iohannis criticized in harsh terms the fiscal measures recently proposed by the government, saying that this so-called fiscal revolution would most likely turn into a “fiscal turmoil”. He urged the ruling coalition not to engage Romania in a fiscal economic adventure with a sad ending. Romania-Insider.com (2018) presents some of the president’s arguments against the recent measures adopted by the government:

- Tax revenues represent a vulnerability of the national budget: “we are in a very strange situation. The economy is growing and tax revenues are falling. Instead of having more money at the budget, because we have a growing economy, ironically, we have less money at the budget.
- The social contributions payment transfer from the employer to the employee will not increase the Romanians’ salaries as promised by the ruling coalition, but in some cases the salaries may even decrease.

Even though government representatives tried to convince the public that amendments to the Tax Code would bring important benefits to citizens and companies operating in Romania, not everyone agreed to these plans – instead it brought people’s protests in the street and stirred discontent of trade unions. The people expressed thus the fear that employees’ net income will decrease and the employer will have to pay more money to the state.

The Finance Minister even faced an impeachment motion in parliament over the proposed measures, but the liberal opposition could not obtain a majority of votes.

Concluding remarks

Romania’s PSD adopted a controversial new Fiscal Code, despite widespread opposition from citizens, trade unions and business community.

It seems that the impact of this move of the Romanian government was not thoroughly assessed and the associated uncertainty will incur major risks to the economy. In order to compensate the transfer of social contributions from employers to employees, employers should increase gross wages by at least 20 %. However, they are not legally obliged to do it.

A reason for the new fiscal legislation could be the impossibility to support the increase of salaries in the public sector made by the social democrats through the unitary wage law passed in July 2017 and entering into effect on 1 January 2018. This increase would cost Romania about 5 percent drop in GDP and, in order to make up for that loss, the social democrats came up with the idea of transferring responsibility for social contributions from the employers to the employees causing wages in the public sector to remain the same or even drop (Balkan Insight, 8 November 2017). We present below the prime-minister Mihai Tudose's explanation during the discussion with trade unions members protesting in Victoriei Square in Bucharest the first days of October 2017:

If the transfer of contributions is made, starting in 2018, the implementation of the unitary pay law will have a budget impact of RON 32 billion by 2020 and RON 42 billion by 2022, according to Government's calculations.

If the transfer is dropped, the impact will rise to RON 63 billion by 2022, which would endanger the deficit. For the time being, the Government has no solution to finance the difference of RON 21 billion from other sources but the Prime Minister has promised the union members that he will consider the possibility of compensating these additional losses to the budget." (Source: Bechir, 2017).

The worrying conclusions of Romania Country Report 2017 (European Commission 2017) may also have urged the government to find solutions for attracting budget revenues. This report averts that fiscal policy turned pro-cyclical in 2016 and the deficit is widening; driven by significant tax cuts and expenditure hikes, the general government deficit increased to 2.8% of GDP in 2016 and is projected to increase further to 3.6% in 2017 and 3.9% in 2018; the structural deficit is projected to widen from below 1% in 2015 to around 4% in 2017, above its medium-term objective.

The new personal income tax brings Romania to the same level with the neighboring country Bulgaria, where the flat income tax rate is 10% since 2008 (Bulgarian Ministry of Finance, National Revenue Agency), demonstrating itself a successful fiscal policy.

Even with 16%, Romania was already in the group of EU countries with the lowest personal income tax: Bulgaria 10%; Czech Republic 15%, Hungary 15% and Lithuania 15%[2]. However, this indicator should be attentively considered, taking into account that other taxes apply, especially that in the above mentioned countries, taxes on goods and services tend to be higher than in other EU member states.

As Bechir (2017) remarks, The Romanian "social experiment" is unique in Europe by eliminating the principle of social solidarity and responsibility on which security systems are built, to which both employers and employees contribute. At the same time, the employees will become more aware of the labor cost.

The implications for local communities should be also taken into consideration. Cutting income tax from 16% to 10% could prevent cities from undertaking projects for their development. For example, in 2017, the budget of the Bucharest City Hall stood at RON 4 billion, out of which RON 3.6 billion came from the income tax. In the aftermath of the fiscal revolution, the Bucharest City Hall is projected to lose RON 1 billion per year (Romania-Insider.com, 8 November 2017). The government promised to give local administrations compensatory sums, but it is not yet clear if they really cover the loss of income taxes.

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3. Bulgarian Ministry of Finance, National Revenue Agency, www.nap.bg/en/page?id=514, last accessed January 2018.

[2] Since 1 January 2001 Russia practices as well a low personal income tax of 13%, being the first large country to adopt a flat tax system. Its introduction was in generally heralded as a success story, being credited with significant increases in tax revenues.

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