

CHOOSING BETWEEN SMALL AND MIDDLE ENTERPRISES AND SELF-EMPLOYED PERSON IN TERMS OF TAXATION

ISPAS ROXANA

ASSOC. PROF. PH.D., UNIVERSITY OF CRAIOVA

e-mail: roxispas1972@yahoo.com

Abstract:

This paper presents the advantages and disadvantages of small and middle enterprises (SMEs) in relation with a registered sole trader (RST). This comparison is necessary since from the 1 st of January 2016, all registered sole traders are required to pay CAS (10.5% or 26.3% according to their option) calculated the net revenue gained, besides the CASS of 5.5% and the income tax of 16%. At the same time, a part of the private entrepreneurs will have to choose if they suspend or cease their activity under the form of registered sole trader or establish a small enterprise.

KEYWORDS: small enterprise, taxation, registered sole trader, incomes

JEL Classification: E62, G17, H25,L21

1. Introduction

If we analyze one of the principles of the new Fiscal Code, namely the neutrality principle which states: "neutrality of fiscal measures in relation to various categories of investors and capitals, as well as to type of ownership, thereby ensuring by the mean of taxation level equal conditions for investors and Romanian and foreign capital", we can conclude it is possible for the persons who are self-employed or freelancers to close these forms of activity and transfer their activity to microenterprise (a.k.a. small enterprise).

2. Theoretical fundaments, method and results

The threshold for categorizing a business as small company/microenterprise has increased from EUR 65,000 to EUR 100,000, after the approval by the Government of an Emergency Ordinance on the 27th of October.

All entities that were founded before the year 2016 will continue to apply the tax rate of 3%, regardless of the number of employees, the reduced tax rate of 1% being designated for entities that will be founded the 1st of January 1, 2016.

Another important condition is that the associates should not have held securities in other entities. Thus, this reduced rate is not available to all micro enterprises.

During the year, associates are not allowed to use company money for personal purposes. After approving the financial statements, they may distribute profits in dividends, supporting an additional tax of 16% of the amount distributed.

Starting with the 1st of January 2017, the tax on dividends will decrease from 16% to 5% and for dividend incomes the health contribution due will be of 5.5%, even if the beneficiary is an employee or obtains incomes from other activities.

Currently, in the case of microenterprises, the income tax rate is 3% without the need to meet any conditions or criteria. However, according to GEO no. 50/2015 amending Law no. 227/2015 - the New Fiscal Code, published in the Official Gazette no. 817/3 November 2015, the taxation shall be applied as follows for all small enterprises that will operate in 2016:

- 1% for microenterprises that have two or more employees;
- 2% for microenterprises that have one employee;
- 3% for microenterprises without employees.

These rates are valid for companies already established. If the number of employees fluctuates along the year, the tax rate of 1%, 2% or 3% is applied properly, starting from the quarter in which the change was made.

In the case of small enterprises that have one employee, respectively two persons and are applying tax rates of 2% and 1%, whose employment relationship is terminated, the provision regarding the number of employees is considered satisfied if during the same quarter new employees are hired.

For microenterprises which have no employee or have one or two employees, in the event that their number changes, in order to maintain / change the afferent tax rates, new employees should be hired with individual labor contract on fixed term for at least 12 months or indefinite period, the employee being that person employed with full time individual labor contract.

There are also accepted the situations in which microenterprises have persons employed with part-time individual labor contracts, but only if all the part-times taken together represent the equivalent of a full time norm.

We believe it is not profitable for a small company to hire "on paper only or just in acts" so to benefit from a reduced income tax because the remuneration of new employees will be at least equal to the minimum wage.

From the 1st of January 2016, if the minimum wage will be 1,200 lei, any employer/company will pay a monthly income tax of 124 lei (without dependents) and social contributions of 471 lei, so the state budget will receive from it an amount of 595 lei.

Payroll taxes for a period of 1 year will be 7.140 lei (595 lei x 12 months).

We shall analyze the situation when the small enterprise would have incomes of 200,000 lei and no employees, respectively has a single employee.

If it would not have employees, the income tax would be of 6,000 lei (200,000 lei x 3%), and for one employee it would pay an income tax of 4,000 lei (200,000 lei x 2%), meaning only 2,000 lei will be saved, given that it has paid the salary tax of 124 lei x 12 months = 1488 lei and the social contributions of 471 lei x 12 months = 5652 lei, in total 7.140 lei / year.

In conclusion, the microenterprise will pay more to the state budget with 5.140 lei (7.140 lei - 2,000 lei) because it hired "on paper only" a person in order to "qualify" for a reduced rate of income taxation.

If the associate / owner / founder of the company are employed to its company with a full time labor contract, he will realize a substantial tax saving, benefiting in addition of health insurance and a full stage of pension contribution.

In the case of sole registered trader, although the amounts paid to the state budget are double or even triple, these people do not receive the full stage of pension contribution and no paid sick leave.

Until 2016, CAS was paid on a base chosen by the PFA, but that could not be less than 35% of the average gross monthly wage. Since 2017, the calculation base is more than 5 gross average salaries, this ceiling being applied to CASS as well. On the other hand, CASS will be mandatory for dividend incomes from 2017, irrespective of whether they receive or have income from other sources, such as wages and self-employment, meanwhile.

We exemplify all above mentioned by a small company that has no employees currently (November 2015) but it shall employ a person with full-time labor contract in April 2016.

In this case, even if the company had no employees at the 31st of December 2015, since April 2016 it will have an employee and will use the 2% income taxation rate starting from the second quarter of 2016.

For newly established Romanian legal persons, the tax rate will be 1% for the first 24 months from the date of foundation and will be applied until the end of the quarter in which the period of 24 months ends if:

- have at least one employee, provided the employment is made within 60 days including the foundation date;
- are established for more than 48 months; and
- shareholders / associates did not hold fund units in other legal entities.

If the newly established Romanian legal entity, in the first 24 months, no longer has any employee, the tax rate of 3% will be applied from the first quarter in which the changes were made.

If the employment is terminated and there is only one employee, the company will apply the reduced taxation rate of 1% only if it hires a new employee in the same quarter.

In conclusion:

- new firms, which are established after the 1st of January 2016, will use the 1% rate for the first two years of existence even if they have only one employee;
- firms that are not newly established and have 2 or more employees, will use the 1% rate;
- companies that have no employees at the 31st of December 2015 may transfer to reduced rates of taxation starting from the quarter in which they have employees.

These taxation percentages are applied to incomes made by a small company (in general, provision of services), without taking into account if they are in profit or loss. There are advantages for the microenterprises with high rates of profit that operate in the trade of goods.

As an exception, not all provisions of services are in the microenterprise's field of activity.

A company loses its status as microenterprise when it achieves more than 20% of its revenue from consulting and management, or is performing activities in the following domains: banking, insurance and reinsurance, capital market, gambling business and the activities of exploration, development and exploitation of oil and gas deposits.

Small businesses - PFA, SRL, micro enterprises - may also be affected by new taxes on buildings, if their headquarters are registered in the household and operate there.

Local taxes are, in 2016, determined by considering for what a building is used. Therefore, if they develop the activity in their houses and all utilities are deducted, they will pay a higher tax compared to that paid in 2015.

These persons must submit, on March 31, a statement to the directions of local taxes based on which their tax will be calculated. Thus, if they do not have any current activity and utilities are not deducted, they can declare this on oath and the tax will be further calculated for residential buildings.

The most advantageous form of tax optimization is the small enterprise in which the employer is also employee, respectively the provision of services; in this case the added value is brought by the founder himself or the associate in the company.

We shall exemplify by a comparative case study, namely the microenterprise without employees and the small enterprise in which the employer is also employee.

A company achieves a turnover of 100,000 Euros, the valid exchange rate being 1 euro = 4.5 lei, and its profit is 40,000 Euros.

In the first case, when the employer of microenterprise is not an employee as well and does not realize other incomes, the taxes afferent to 2016 are:

- a) Microenterprise's income tax $I_{vm} = CA \times 3\% = 450.000 \text{ lei} \times 3\% = 13.500 \text{ lei}$;
- b) Tax on dividend income $I_{vd} = (CA - I_{vm}) \times 5\% = (450.000 \text{ lei} - 13.500 \text{ lei}) \times 5\% = 21.825 \text{ lei}$;
- c) Because the individual does not realize other income, he will pay the health contribution in percentage of 5.5% of the gross dividend, namely the amount of $I_{vd} \times 5, 5\% = 21.825 \times 5, 5\% = 24.007 \text{ lei}$.

Total taxes = 13.500 lei + 21.825 lei + 24.007 lei = 59.332 lei.

In the second case, when the employer is also hired in his company with a minimum wage of 1,200 lei per month, we have the total salary costs (gross salary + employer's contributions) = 1.476 lei per month, out of which the taxes that are monthly discharge to the state budget are amounting to 598 lei / month.

Taxes in 2016 are:

- a) Microenterprise's income tax = 40.000 euro $\times 4, 5 \text{ lei/euro} \times 2\% = 3.600 \text{ lei}$;
- b) Total costs in the period = $3.600 \text{ lei} + (1.476 \text{ lei} \times 12 \text{ months}) = 3.600 \text{ lei} + 17.712 \text{ lei} = 21.312 \text{ lei}$;
- c) Net profit = $180.000 \text{ lei} - 21.312 \text{ lei} = 158.688 \text{ lei}$;
- d) Tax on dividend income = $158.688 \text{ lei} \times 5\% = 7934,4 \text{ lei}$.
- e) Total payroll taxes = $598 \text{ lei} \times 12 \text{ lei} = 7.176 \text{ lei}$.

Total taxes = 3.600 lei + 7.934,4 lei + 7.176 lei = 18.710,4 lei.

Therefore, we must point out that the founder of company will make a substantial saving related to taxes if he is employed to its company with a full time labor contract, even with the minimum wage, and in addition he will benefit of health insurance and a full stage of pension contribution.

Assuming that **are gained the same incomes** of 450,000 lei as a sole registered trader in 2016, the contributions in 2016 will be

- a) Healthcare contribution in percentage of 5, 5% = $450.000 \text{ lei} \times 5, 5\% = 24.750 \text{ lei}$;
- b) Pension contribution in percentage of 10, 5% and it is capped at 5 times the average gross salary (we consider this salary to be 2.400 lei) = $(5 \times 2.400 \text{ lei}) \times 10, 5\% \times 12 \text{ months} = 1.260 \text{ lei} \times 12 \text{ months} = 15.120 \text{ lei}$;
- c) Income tax in percentage of 16%, applied to the gross income minus the two contributions = $(450.000 \text{ lei} - 24.750 \text{ lei} - 15.120 \text{ lei}) \times 16\% = 65.620,80 \text{ lei}$.

Total taxes = 24.750 lei + 15.120 lei + 65.620,8 lei = 105.490,80 lei.

3. Conclusions

Taxation in the case of SRT involves important sums (double or even triple) allocated as contributions to the state budget, and these people are not benefiting of a full stage of pension contribution and no paid sick leave.

We think that the most advantageous form of tax optimization is the microenterprise in which the employer is also an employee, including the provision of services, because the added value is brought by the company's founder himself.

Before taking the decision to close the PFA, there are a number of limitations in the case of micro-enterprises, such as:

- If, by the activity carried out are gained revenues higher than 65,000 Euros, the ceiling in lei being established by using the exchange rate at the end of previous year, a PFA can not be classified as micro enterprise (firms that exceed this limit must pay a tax of 16% of profit obtained, since there are no major differences between such a company and a PFA, in terms of the tax regime);
- it must be taken into account the object of activity unfolded, because it can not be classified as micro enterprise if the share of revenue gained from management and consulting exceeds 20% of the total income;
- in the case of a legal entity, financial resources can not be used during the year, but only after approval of financial statements and incurring of the tax on dividends

Bibliography:

- [1] www.mfinante.ro
- [2] www.e_guvernare.ro
- [3] www.anaf.ro