

LEGAL FORM OF BUSINESS ORGANIZATION - A METHOD OF FISCAL OPTIMIZATION

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Abstract

A fiscal optimization method of companies is rendered by their ability to choose among the various methods to legally organize performance set out by the Romanian legislation. In this respect, a taxpayer may choose to organize their activities in their capacity as self-employed persons, sole proprietorships, family owned companies, free lancers, beneficiaries of copyright revenues, limited liability companies, small enterprises, joint stock companies. When a taxpayer may chose the most favorable variant to their legal status from among the ones provided by the legislation, the aim of this research paper is to show the fiscal impact generated by a natural person's choices to raise incomes from activities performed as an employee, as an authorized natural person or in a trading company, namely a small enterprise. The outcome emphasizes the fact that from the perspective of the net income raised by a natural person, their most favorable business organization form is the choice to act as a small enterprise.

Key words: Fiscal optimization, fiscal cost, income of natural person, small enterprise, authorized natural person

JEL Classification: H29, M21

1. Introduction and Context of this Survey

The aim of this survey is to show a way of fiscal optimization which can be used by a natural person paying taxes, respectively fiscal optimization at choice. Thus, the author shall approach the term of fiscal optimization in the context where a natural person may choose one income form or another, by performing a case study which aims at comparing fiscal costs in various forms of raising incomes.

"In a broad meaning, any taxpayer while representing their concerns for protecting their own assets resorts within the limits of fiscal and criminal legality to a variety of deeds or omissions meant to decrease the amount of their tax duties. A taxpayer's acts in terms of avoiding or lowering taxation are a reaction typical of all fiscal systems".[1]

Fiscal optimization involves observing the interests of lawmakers without using any legislation interpretation solely to the benefit of taxpayers. All the elements of fiscal cost optimization namely the taxable base, operations, transactions must be clearly detailed in fiscal and accounting reports of taxpayers. Fiscal optimization does not mean infringing the law, but on the contrary it is accomplished by following the legal regulations in force. Therefore, fiscal optimization may contribute in increasing organizational competitiveness due to a reduction in the fiscal cost.

Fiscal cost optimization refers to each and every activity unfolding within legal limits and aiming at minimizing tax duties by the reduction in, delay of or exemption from tax duties, the recovery of debts and the lack of fiscal debts, avoiding the circumstances where tax deductibility is not accepted, performing taxable activities where costs, taxation level and tax risks are the lowest.

Fiscal optimization also means the consequence of a company's financial management since management decisions influence a taxable base which implicitly affects a tax burden. "Efficiently managing the economic and financial resources of an enterprise means taking account of the fiscal aspect of business. According to the fiscal analysis in synthesis documents one can determine past, present and future performance, limit the risks and set fiscal efficiency".[2]

"In the above-mentioned context, one can define fiscal cost optimization as the analysis activity in terms of fiscal implications upon economic transactions in order to choose the best variant to meet the optimization criterion selected, namely that of minimizing a fiscal cost".[3]

2. Fiscal Optimization at Choice

Fiscal optimization at choice refers to a taxpayer's ability of choosing a tax solution which they find favorable from among several choices provided by the law.

Thus, a taxpayer can choose: to develop their own business as a natural person paying income taxes or as a legal person paying corporate taxes or taxes on small enterprise income; to pay a value added tax or not; the business duration and the way to get out of business; the business nature and type – trade, industry, services etc.; accounting policies to be applied; the method of funding the business which can be provided by banks, leasing, loans from partners; shareholders who can be legal or natural persons; the way to distribute dividends; the way to compensate employees, the method of distribution and retailing used by a company; the outlet of goods at local or foreign levels and the place where the company is supplied; the way to conduct transactions with related entities.

As far as the choices of natural persons are concerned, they can chose to run their activities as employees, as authorized natural persons or they may choose to run their activities by virtue of a civil agreement. A civil agreement involves the occasional rendering of services without having a professional nature.

Fiscal optimization in this context is rendered by salary taxes versus taxes on incomes from self-employed activities as well as by the level of social security contributions mandatory in the three contexts.

Salary incomes include the following deductions:

- the rate for social security contributions which is laid down according to labor conditions such as 31.3%, 36.3%, 41.3%, of which 10.5% for individual contributions and the difference is represented by the rate payable by an employer;
- the rate for healthcare contribution amounting to 10.7%, of which 5.5% for individual contributions and 5.2% for the rate payable by an employer;
- the rate for unemployment related contribution of 1% of which 0.5% for individual contributions and 0.5% for the rate payable by an employer;
- the rate for the insurance contribution related to occupational accidents and diseases ranging between 0.15%-0.85%;
- the rate for the contribution in setting up the guarantee fund is set by applying a rate of 0.25%, payable by an employer;
- the rate for the contribution in holidays and health insurance allowances of 0.85%.
- salary tax of 16%.

Incomes from self-employed activities are impacted by the following deductions:

- the rate for social security contributions such as 31.3%, 36.3%, 41.3%, to be entirely paid by a natural person. Authorized natural persons including sole proprietorships and family owned business which exclusively raise a gross income per calendar year equal to at least four times the average gross earnings used to substantiate the state social security budget [5], namely 8,892.00 Lei ($4 * 2,223.00$ – the average earnings in 2013) have to pay social security duties. The calculation basis [5] is provided by the monthly income stated in the insurance statement but it cannot be lower than 35% of the average wages agreed upon when substantiating the social security budget ($35\% * 2,223.00 = 778.05$) or higher than five times its amount ($5 * 2,223.00 = 11,115.00$). Thus, the minimum contribution to be paid at the pension directorate is 243.52 ($31.3\% * 778.05$).
- the rate for healthcare social security of 5.5%;
- the income tax of 16%.

The incomes raised from vocational activities performed under civil agreements are affected by the following deductions:

- the individual rate for social security of 10.5%;
- the individual rate for unemployment related security of 0.5%;
- the income tax of 16%.

Since the income tax is the same both in terms of the income raised as a salary and for the incomes raised from self-employed activities namely 16 %, what is interesting from the perspective of fiscal optimization is the level of mandatory duties paid and their taxation bases.

Table 1. Mandatory Contributions Associated to Incomes

Mandatory contributions associated to salary incomes	44.25%
Mandatory contributions associated to incomes raised from self-employment	36.8%
Mandatory contributions associated to incomes raised from activities under civil agreements	11%

The taxation base is represented by:

- salary incomes of employees;
- net incomes raised from self-employment;
- gross incomes raised under civil agreements.

The effect of fiscal expenses' optimization is rendered by minimizing the taxation base which can be provided to net incomes raised from self-employment by means of deductible expenses. In this respect, the activities requiring the monthly use of raw materials, equipment, consumables etc. are more advantageous from the fiscal point of view if they are organized in the legal form of a legal entity.

For instance, a person providing woodwork services to several people may conclude with each beneficiary either a labor contract, a part-time labor contract or he/she organizes his/her activities as an authorized natural person. If a service provider claims a tariff of 20 Lei/hour and performs 120 working hours per month, the taxable base for his/her salary income would be 2400 and for the incomes raised from self-employment, the taxable base would be 2400 minus material costs, costs of transport to the place of service rendering, working equipment expenses.

A major tax advantage of authorized natural persons arises when they are employees and hold an employment record book. In such a circumstance, the legal regulations in force [5] do not include the obligation to calculate and pay social security contributions because the authorized natural person does no longer raise such an income exclusively. Thus, the only obligation is the rate of 5.5% for individual healthcare social security contributions to which the 16% income tax is added. The fiscal burden in this context is 21.5% to the authorized natural person as compared to 52.80% if they were to raise incomes from self-employment exclusively. Therefore, there is a fiscal cost saving of 31.3%. Additionally, as compared to incomes raised from salaries where the fiscal burden is 60.25% (44.25% as mandatory contributions and 16% salary income tax), there is a fiscal cost saving of 38.75%.

Moreover, a natural person may choose from among a salary income, an income raised from self-employment as an authorized natural person or an income from activities of a trading company, namely a small enterprise.

Since a fiscal burden corresponding to a natural person who is employed namely the foregoing authorized natural person, it should be added that the fiscal burden of a trading company is made up of a 16% corporate tax, respectively a 3% income tax in the case of a small enterprise and 16% as dividend tax.

The example below includes a comparison of the fiscal costs namely the net incomes of a natural person from various forms of organization which he/she may choose. The example starts with the gross income amount of 3,000.00 Lei.

Table 2. Fiscal Cost and Net Income Resulting from Business Organization Form

Tax/Contribution	Rate	Employed	Authorized Natural Person	Small Enterprise
Gross income raised		3,000.00	3,000.00	3,000.00
Social security contribution of an employee (3,000.00 * 10.5%)	10.50%	315.00		
Healthcare social security contribution of an employee (3,000.00 * 5.5%)	5.50%	165.00		
Unemployment related contribution of an employee (3,000.00 * 0.5%)	0.50%	15.00		
Salary tax ((3,000 - (315.00 + 15.00 + 165.00)) * 16%)	16%	401.00		
Net salary		2,104.00		
Social security contribution of an employer (3,000.00 * 20.8%)	20.80%	624.00		
Healthcare social security contribution of an employer (3,000.00 * 5.2%)	5.20%	156.00		
Unemployment related contribution of an employer (3,000.00 * 0.5%)	0.50%	15.00		
Contributions for holidays and allowances for healthcare social security (3,000.00 * 0.85%)	0.85%	26.00		
Contributions for insurance of occupational accidents and diseases (3,000.00 * 0.40%)	0.40%	12.00		
Contribution to set up the guarantee fund (3,000.00 * 0.25%)	0.25%	8.00		
Social security contribution of an authorized natural person (minimum contribution)	31.30%		244.00	
Healthcare social security contribution of an authorized natural person (3,000.00 * 5.5%)	5.50%		165.00	
Income tax of an authorized natural person ((3000.00 - (244.00 + 165.00 + 100.00)) * 16%)	16%		398.56	

Income tax of a small enterprise (3,000.00 * 3%)	3%			90.00
Dividend tax ([3,000.00 – (90 + 200.00)] * 16%)	16%			433.60
Expenses associated to accounting records*			100.00	200.00
Contributions of employer (624.00 + 156.00 + 15.00 + 26.00 + 12.00 + 8.00)		841.00		
Total cost of employer		3,841.00	3,000.00	3,000.00
Net income of authorized natural person		2,104.00	2,092.44	2276.40

*With respect to an authorized natural person and a small enterprise, a cost of 100 Lei/per month respectively 200 Lei/per month is estimated which means expenses for accounting and fiscal records.

As it can be seen in the example mentioned above, the most favorable form of business organization from the perspective of net income raised by a natural person is the choice of operating as a small enterprise. "Yet, there are also negative effects upon an employee which manifest themselves as decreasing the calculation base for pensions. The decrease can be compensated according to the increase in the income of a natural person of which some can be invested by paying in a private pension system." [4]

5. Conclusions

A natural person paying taxes has the full freedom of deciding to render services either as an employee, as an authorized natural person or as a trading company, each of the three business organization forms having a different fiscal impact. Fiscal optimization is determined individually in each case, according to the way of business operation, the needs of services beneficiaries, as well as according to the way one assumes the risks of their own business activities.

6. References

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