

# Direct Taxation of Certain Activities in Romania: Specific Tax

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## Abstract

*Direct taxes are one important instrument for governments to influence economic activities, but also to reduce tax evasion. In 2017, Romanian regulators introduced new lump-sum tax on certain activities. The aim was to impose an annual payment for companies that activate in tourism and food sector, regardless of their financial situation. Profit is no longer taken into account in these cases, but some particular variables.*

*Present paper aims to detail the way that specific tax is calculated, given the different sectors that are affected by the new legislation.*

**Key words:** legislation, lump-sum tax, annual specific tax

**J.E.L. classification:** H20

## 1. Introduction

Ideally, a country's tax system should be neutral with regard to its impact on business decisions (OECD, 2015, p.13). Still, governments around the world adopt fiscal measures that inevitably advantage some sectors and disadvantage others. As a consequence, companies may profit from different taxation legislation.

Lump-sum tax is a pre-established, invariable tax. It is not a profit-based tax and it affects both large and small companies, but places greater relative burden on the latter (Mankiw et al, 2009, p.149). For such reasons, it is rarely preferred and only for limited periods.

On the other hand, such type of tax provides scope for improving efficiency, equity and simplicity of tax system (Peichl, 2014, p.9). Moreover, it is an instrument of combating the widespread phenomenon of tax evasion (Paliu-Popa et al., 2010, p. 80). Hence, given that some economic sectors may be inclined to tax evasion and control is difficult to administer, governments may advocate lump-sum tax. This is the case of Romania.

Starting with January 1st 2017, a new type of lump-sum tax has been introduced in Romanian legislation, called specific tax. This new type of tax addresses to companies that activate in specific domains, respectively the ones that activate in tourism sector, restaurants and food sector. Practically, a new tax system has been introduced by the Law no.170/2016, which imposes calculation of annual specific tax for targeted sectors by taking into account certain variables, such as rank of locality where company is located, total area for targeted activities or seasonality. As a consequence, financial results of such companies are no longer taken into account when calculating tax.

## 2. Lump-sum tax in Romania

According to Law no.170/2016, specific tax on certain activities is owed by companies that cumulatively fulfill two conditions: have included within constitutive acts at least one of the targeted CAEN codes as main or secondary activity and are not in liquidation. Targeted CAEN codes are:

- 5510 - Hotels and other similar accommodation facilities
- 5520 - Accommodation facilities for vacations and short term periods
- 5530 - Parks for caravans, camping and camps
- 5590 - Other accommodation services
- 5610 - Restaurants
- 5621 - Catering
- 5629 - Other food services
- 5630 - Bars and other beverages serving activities.

Thus, all companies that develop such activities must pay specific tax, except microenterprises. It is important to note that starting with November 2017, firms having a maximum income of euro 1 million are considered microenterprises. Consequently, a smaller number of companies are liable for annual specific tax payment. Originally, such companies were not exempted from payment.

As Law no.170/2016 regulates, specific tax varies accordingly to the area where companies are located, stating that calculation of this new tax is based on area categories within Romania, grouped as follows:

- Bucharest and 8 important poles, respectively Brasov, Cluj-Napoca, Constanta, Craiova, Iasi, Ploiesti, Sibiu, Timisoara;
- municipality and cities, other than ones above;
- national resorts;
- villages and local resorts.

Annual specific tax is determined for each operating unit, by using specific formula, and resulted sum is considered tax liability. Given type of activity, formula is established distinctively for restaurants, bars and catering services and for accommodation services, as Figure no.1 shows.

Table no.1 Formulas used in calculus of specific tax

Type of activity	Formula
Accommodation	$k \cdot (\text{no. of accommodation seats})$
Bars	$k \cdot (x + y \cdot q) \cdot z$ , where $k = \text{Lei } 900$ and $q = 0.9$
Restaurants and catering services	$k \cdot (x + y \cdot q) \cdot z$ , where $k = \text{Lei } 1400$ and $q = 0.9$

Source: (Romanian Parliament's Law no.170/2016, 2016, pp.6-9)

Note that:

$k$  = standard tax value;

$x$  = variable according to rank locality;

$y$  = variable according to commercial usable / serving / activity area;

$q$  = adjustment factor for technical unit space;

$z$  = seasonality coefficient.

According to Figure no.1, given restaurants or bars of same commercial usable area, location of their activity is main factor in establishing specific tax. This is highlighted by the fact that variable related to rank locality and seasonality coefficient decrease as location varies from Bucharest and the 8 poles mentioned above (Brasov, Cluj-Napoca, Constanta, Craiova, Iasi, Ploiesti, Sibiu, Timisoara) to villages and resorts. Hence, new legislation takes into account location potential, although such activities may not generate similar income.

Let's take, for example, the case of a restaurant of 125 square meters. As seen in Figure no.2, there are important differences between values of specific tax owed by restaurants located in different regions of Romania. Such disparities may lead to relocation and, on the medium term, may influence firm's investment decisions. Indeed, the effect of fiscal policies may transform a given jurisdiction into a more or less attractive one (Galletta et al., 2016, p.2).

Table no.2 Examples of specific tax calculus

Location	Annual specific tax for restaurants	Annual specific tax for bars
Constanta (zone A)	$1400 \cdot (15 + 29 \cdot 0.9) \cdot 0.45 = \text{Lei } 25893$	$900 \cdot (14 + 14 \cdot 0.9) \cdot 0.45 = \text{Lei } 10773$
Tulcea (zone A)	$1400 \cdot (13 + 29 \cdot 0.9) \cdot 0.35 = \text{Lei } 19159$	$900 \cdot (12.5 + 14 \cdot 0.9) \cdot 0.35 = \text{Lei } 7906.5$
Mamaia	$1400 \cdot (5 + 29 \cdot 0.9) \cdot 0.3 = \text{Lei } 13062$	$900 \cdot (2 + 14 \cdot 0.9) \cdot 0.3 = \text{Lei } 3942$
1 Mai	$1400 \cdot (3 + 29 \cdot 0.9) \cdot 0.1 = \text{Lei } 4074$	$900 \cdot (0.4 + 14 \cdot 0.9) \cdot 0.1 = \text{Lei } 1170$

Source: (Finances Minister's Order no.464/2016, 2016, pp. 1-10)

For accommodation units, annual specific tax is calculated given ranking and number of seats. Standard tax value (k) differs by accommodation ranking stated by certificate of classification. Seasonality is taken into consideration only for accommodation units located on the seashore, as in such cases, number of activity days is related to number of days in a year. Number of activity days is stated by operating license or classification certificate issued by specialized institutions.

The Implementing Rules of Law no.170/2016 state that companies within the tourism and catering sector which also carry out other types of economic activities must pay a mixed tax starting with January 1st 2018. Hence, mixed tax regime is established for mixed-activity companies as follows:

- specific tax for activities corresponding to the eight CAEN codes listed above;
- corporate income tax for other activities.

This is not classified as double taxation, as revenues related to specific tax are excluded from calculation of corporate income tax. Thus, for example, if a company which owns a hotel and a restaurant carries out other economic activities, such as car service and car wash, owes mixed tax, respectively a specific tax due to accommodation and food services it offers, but also corporate income tax (profit tax) due to car service and car wash services. Still, exemptions refer to micro-enterprises, so, in such cases, they are excluded from paying mixed tax.

In cases of temporary inactivity, closing down or other particular situations, regulators strictly specify how tax liability is established. Table no.3 resumes these particular situations.

Table no.3 Particular cases

Situation	Consequence
Company closes down within a year	Owes specific tax, determined by taking into account number of days of activity within year
Company loses operating license/certificate of classification	Owes corporate income tax starting with next semester
Company has reported temporarily inactivity to trade register	Does not owe annual specific tax starting with next semester
Period of inactivity ends	Owes tax starting with next semester

Source: (Romanian Parliament's Law no.170/2016, 2016, p.3)

### 3. Specific tax for resorts

Law no.170/2016 particularly distinguishes resorts, which include not only accommodation facilities, but recreation, wellness, restaurant and bar services. In such cases, companies must calculate and pay annual specific tax only for accommodation services. Still, if total number of accommodation seats exceeds total number of seats in restaurants and bars, annual specific tax is owed for the number of exceeding seats. This is determined by using formulas related to restaurant or bar activity, as seen in Table no.1.

In other words, a comparison must be made between these two ones, in order to establish which one is the biggest. Therefore, if number of seats corresponding to each type of food service is below number of accommodation seats, specific tax is calculated as mentioned above. In the latter case, if number of seats corresponding to each type of food service is bigger than number of accommodation seats, specific tax must be distinctively calculated for the exceeding number of seats, for type of activity related to this excess.

Let's take, for example, a resort in Mamaia which includes a 4 star hotel of 140 rooms and 280 accommodation seats, restaurant A of 180 square meters and 90 seats, restaurant B of 120 square meters and 60 seats and a bar of 80 square meters and 40 seats. In this case, specific tax is established by making following comparisons:

- number of hotel seats vs. number of seats in restaurants:  $280 > (90+60)$ ;
- number of seats in hotel vs. number of seats in bar:  $280 > 40$ .

In this case, number of seats in restaurants and bar is considered assigned to number of accommodation seats. Hence, resort has the following tax liability:

$$\text{Annual specific tax} = \text{Lei } 271 * 280 = \text{Lei } 75880.$$

Further, we will discuss the case of a resort in Poiana Brasov which includes a 5 star hotel of 110 rooms and 220 accommodations seats, restaurant X having 290 square meters and 145 seats, restaurant Y having 160 square meters and 80 seats, bar K having 80 square meters and 40 seats and bar L having 50 square meters and 25 seats. Annual specific tax is determined in this latter case as a sum of specific taxes, starting with same comparisons:

- number of hotel seats vs. number of seats in restaurants:  $220 < (145+80)$ ;
- number of seats in hotel vs. number of seats in bars:  $220 > (40+25)$ .

Given that there are 5 exceeding seats in restaurants, area for each of these seats must be determined, as follows:

$$\frac{\text{Total area of restaurants}}{\text{Total number of seats in restaurants}} = \frac{290+160}{145+80} = 2 \text{ square meters/seat.}$$

Hence, for 10 square meters, specific tax is calculated for restaurant activity:

$$\text{Annual specific tax for restaurants} = \text{Lei } 1400 * (5+2*0.9) * 0.3 = \text{Lei } 2856$$

$$\text{Annual specific tax for hotel} = \text{Lei } 448 * 220 = \text{Lei } 98560$$

$$\text{Total annual specific tax} = \text{Lei } 2856 + \text{Lei } 98560 = \text{Lei } 101416.$$

Resorts that offer tourists other additional services, apart from accommodation, are taxed according to specific tax rules if such services are included in the total price of package, as they represent resort's income. Contrarily, in case tourists and other clients are offered such services but are not included in total price package, the resulted income is subject of corporate income taxation. Such services include hairdresser, manicure, pedicure, parking.

#### 4. Conclusions

Changes in taxation system have major effects on companies' activity. Introduction of lump-sum taxes, although for limited periods, is obviously intended to generate benefits for state budgets. Apart from their quantifiable benefits, such taxes lead to several amendments of tax systems, as the ones that Romanian regulators targeted:

- simplification of tax calculation;
- increases in tax compliance;
- abatement of tax avoidance;
- reduction of tax evasion.

Still, Romania's recently designed specific tax had no ample effects on state budget (at the time of writing present article), as few companies within tourism and food sector became liable to such tax. This is because according to new legislation many firms became eligible as microenterprises. Consequently, we consider that future corroboration of legislation is necessary in order to benefit Romanian tax system.

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