BUDGET CONSOLIDATION AND HIGHER FISCAL REVENUES - A VITAL NEED FOR ROMANIA'S STABILITY AND ECONOMIC SECURITY

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** The views expressed in this document are the responsibility of the authors and do not constitute the official position of the institutions to which they are affiliated. The analysis was performed between February 10 and April 30, 2022.*

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Among our economists, there has long been a concern to carry out more in-depth analyzes of the domestic tax regime, that should try to imagine ways to rethink it, to increase tax revenues, which are at an extremely low level compared to European standards. The stated desire of some economists and colleagues and other experts to get involved in a concrete analysis met with the thoughts of the Romanian Fiscal Council, which are not recent. This resulted in the establishment of a Working Group which undertook this research on the domestic tax regime based on the great urgencies of economic policy in such bitter times, with international overlapping crises and a war in Ukraine.

The analysis, which took place between February and April 2022, expresses a common denominator regarding the approach of budgetary consolidation and the rethinking of the tax regime under current and future conditions, even if the Group members have different views on various issues. This analysis, moreover, should be seen as a work in progress.

The members of the Group contributed to this analysis individually, without involving the institutions to which they are affiliated.

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Daniel Dăianu

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INTRODUCTION

The structural problems of the Romanian public budget have been debated for a long time, not only among economists, and are not recent. They are present on both sides of the budget (revenue and expenditure). It is widely known the very low level of tax revenues (including social security contributions) in Romania, of approx. 26% of GDP in recent years, compared to an average of 35-36% in neighboring countries (which entered the EU starting with 2004) and of over 40% across the EU. This situation is not only a major vulnerability of the public budget, but also drastically reduces the possibility of providing society with basic public goods (health, education, infrastructure, etc.), at European standards, in adequate quantity and quality[1].

It is true that, for many years, Romania, as an EU member state, has benefited from considerable European resources (through the Multiannual Financial Framework), which will be massively supplemented by the National Recovery and Resilience Plan (NRRP), but this does not change the severe situation regarding the level of fiscal/budgetary revenues. Although European money supports economic activity, with favorable effects especially during periods of contraction and structural reforms, it usually funds one-off investments and not recurring expenditures.

One figure, in itself, says a lot about the fragility of the public budget: in the last decade, salaries, pensions and other social spending accounted for an average of over 75% of tax revenues (in 2020, the year of the Pandemic, almost 90%). If we add to this percentage the need to make public investments, absolutely necessary public acquisitions, we realize the implications and how serious the situation is - that we have a public budget far from being robust. And this finding predates the war in Ukraine, which brings with it new budgetary challenges in the following areas: military, energy, agri-food, refugee crisis management, etc. Prior to the invasion of Ukraine, the public budget had been under tremendous stress due to the Pandemic and the energy crisis (exacerbated by the war in Ukraine).

The very low level of fiscal revenues is to be analyzed in conjunction with the dynamics of the budget deficit. The first year of the Pandemic is misleading because budget deficits exploded across the EU out of a need to avoid a collapse in economies – as it did during the global financial crisis. Therefore, the relevant size is given by the structural deficit, which at the end of 2019 was over 5% of GDP, probably the highest in the EU. In that year, the primary deficit (excluding interest payments on public debt) was over 3% of GDP, also probably the largest in the EU. The fact is that public debt is not Romania's biggest challenge at the moment (according to the EU methodology, slightly below 50% of GDP in December 2021, respectively 48.9%, and reaching 50.6% of GDP in February 2022, but

[1] However, major issues concerning public spending efficiency are also notorious

increasingly difficult and costly to refinance), but the structural budget deficit[2] which, if not significantly reduced in the coming years, will profoundly destabilize the economy.

Years of pro-cyclical policies, fiscal/budgetary policy errors that have reduced permanent public budget revenues, underestimation of the need to increase tax revenues and to firmly combat tax evasion and all sorts of tax optimizations, giving in to interest groups that have benefited from the weaknesses of the Romanian state, ignoring the golden rule that years of sustained economic growth require the creation, or increase of "fiscal space", have led to a high level of structural deficit and to the inevitable entry into the excessive deficit procedure in March 2020. This was despite the fact that the authorities had been repeatedly warned by the European Commission that a change of approach was needed in budgetary policy.

The macroeconomic/budgetary correction that Romania needs can also be seen from the perspective of the twin deficits (***Annex A***) – the existence of growing external (current account) deficits in recent years. Thus, the current account deficit was around 5% in 2019 and 2020 and increased to approx. 7% in 2021; the trade deficit has been growing steadily, illustrating a problem of competitiveness beyond excess demand. Neighboring countries, to which we usually compare ourselves (Poland, Hungary, Czechia) and which are not part of the euro area, have much more balanced external balances, which is seen in sovereign ratings considerably higher than that of Romania. Also, it is not possible to rely solely on European funds to fully fund external deficits.

The budgetary correction is also needed because monetary policy alone cannot maintain the stability of the national currency, as external deficits have predominantly fiscal causes and the nature (lack) of structural reforms. The more unclear and unconvincing the correction of the budget imbalance, the more difficult the NBR's task will be to ensure macroeconomic stability and the protection of the national currency.

Successive and overlapping crises – Pandemic, energy crisis, implications of the war in Ukraine (which opens the door to a new *Cold War* in Europe and across the world), aging population, the exodus of human capital (which puts great pressure on the social security budget), the impact of climate change, highlights the fragility of our public budget.

It should be noted that, prior to the outbreak of the Pandemic, Romania was the only EU member state subject to the excessive deficit procedure. The suspension of fiscal rules in the EU in the period 2020-2022 does not mean that the need for macroeconomic correction is less urgent, because

[2] The fact that there are discussions on how to measure the structural budget deficit does not invalidate the relevance of this indicator

the markets will penalize the failure of macroeconomic/budgetary correction to enter a credible trajectory, especially in a context of strengthening global monetary policies.

It should also be noted that the excessive deficit procedure is not the first reason for correcting the budget imbalance, but the situation of the economy itself, which makes the trajectory of public debt unsustainable if no correction is made, even a gradual one, given the magnitude of adverse shocks.

Romania's membership in the EU is an important plus from the perspective of avoiding major complications, a balance of payments crisis; the financial assistance package provided by the EU, IMF and WB following the crisis that erupted in 2008-2009 is eloquent in this regard. But EU membership must not weaken the concern for reducing the budget deficit.

The times are very difficult and uncertain, and the war in Ukraine with the implications of a new *Cold War* that is looming, also affect our economy. Therefore, a combination of macroeconomic measures, a policy mix, is needed to try to avoid entering a recession at the same time as the necessary process of correcting the budget imbalance.

In this context, given the overlapping crises faced by both the EU and Romania, the budgetary adjustment can only be gradual, but it must be materialized through credible measures, supported by a strong political endorsement and by large economic and social circles - including the business environment.

At the same time, it is absolutely necessary that decision-makers in the political and administrative environment no longer promote reductions in taxes, as well as increases of permanent expenditures on the account of temporary revenues. Only in this way it will be demonstrated that decision-makers understand the seriousness of the budgetary situation and are determined to address it.

It is worth mentioning that the question "what can be done?" on adjusting the budget imbalance is common among economists and the general public debate. Some theses are summarized as follows: not much can be done to increase tax revenues because the current state of affairs has a "structural" determination based on the functioning of society, of the economy. This is a contradictory, erroneous approach, for several reasons: a) there are countries (e.g. Poland, Bulgaria) where tax reforms have generated revenue increases of 3-4% of GDP; b) the idea that the structural balancing of the public budget can be done strictly by spending cuts is a fantasy given the magnitude of the need for correction; it is in divorce of reality - documents of the Romanian Fiscal Council and other analyzes (including from the European Commission) show why it is not possible; c) the inefficiency of tax revenue collection is documented, obvious – just in the case of VAT we notice a deficit in revenue (VAT gap) of 35% compared to an average deficit in the EU of 10%; tax evasion and optimization, the frequent evasion of income taxation, can be combated if there is political will; in recent years, taxes and duties have been recklessly reduced, causing tax revenues (excluding social security contributions) to fall from approx. 19% to approx. 15% of GDP. And the thesis that most of the adjustment can be achieved through inflation tax is not socially and even economically viable.

The conclusion is obvious and hard to deny: in Romania, a considerable increase in fiscal/budgetary revenues can be obtained through better collection and by reducing the number of exceptions and loopholes in the tax regime, which make it deeply unfair. It is to be welcomed that important voices in the business world, in academia, support the need for a substantial increase in tax revenues.

It should be noted that one of the proclaimed benefits of the single tax rate (lost over time through numerous exemptions and derogations) is the similar tax treatment applied to taxpayers. That is why tax reform should start by correcting the many privileges and inequities in taxation so that taxation is uniform and proportionate, regardless of the nature of the business and the way it is organized. This principle is supported by broad circles in the business community. The undesirable alternative would be *ad-hoc* increases in taxes and fees, imposed by the constraints of funding the twin deficits, which would leave the unfair treatment of taxpayers unaddressed. The authors of the present analysis do not dispute the need for sector policies and specific state interventions in the economy, on the contrary. Moreover, the international context makes such policies inevitable in areas such as energy, the agro-industrial sector, defense, in addition to the challenges posed by climate change, the Pandemic, Ukrainian refugees etc. Therefore, it is estimated that a further increase in budget expenditures will be needed in the future (in relation to the implications of the correction of the budget imbalance), which will have two consequences: on the one hand, it will not be possible to rely on deficit reduction by cutting budget expenditures, and on the other hand, in the medium/long term, budget revenues will have to be further increased, in addition to the increases proposed in this analysis.

At the same time, state interventions in the economy should follow a number of principles, which have been ignored in recent years:

- public spending must be set on a very strict basis, so as to avoid wasting public money. A transparent and efficient system of spending public money should be implemented together with measures to increase tax revenues;
- the single tax rate is based on the principle of proportional income taxation. In fact, through many exemptions from this type of taxation, some taxpayers end up being taxed regressively, while other taxpayers are taxed proportionally, which erodes the spirit of fairness and solidarity in society. If it is desired to keep these specialists in the country, a fair solution would be to increase their salaries in parallel with their taxation according to the general rules;

- companies should not benefit from multiple tax privileges. For example, it is sufficient for micro-enterprises (and those, redefined correctly) to have a different tax regime than for small, medium or large enterprises. But it is not normal for large companies to benefit from other sector-specific facilities;
- policies to support certain sectors should aim to increase their investment and productive capacity and not just to maintain a certain level of purchasing power or consumption. For example, in agriculture, other measures could be devised instead of fiscal incentives granted to farmers, when in fact the big problems affecting this sector are the lack of an efficient irrigation system, the lack of appetite for association of producers (which puts them in inferior positions when negotiating with large chain stores, transport and storage companies, suppliers of seeds and fertilizers etc.) and the abolition of vocational schools;
- permanent expenditures cannot be financed with temporary revenues, be it grants from the European Commission. In addition, this is a reason to take the issue of increasing budget revenues seriously.

Budgetary consolidation through increased tax revenues is a matter of national economic security and national solidarity, especially if we consider the enormous challenges for economy and society – energy transition, effects of climate change, demography (especially migration – the exodus of human capital), the need to increase defense spending (which equates to the erosion of the "peace dividend" obtained after the fall of the Berlin Wall – a matter that concerns the entire European Union[3]), to increase investment in health and education. It should be noted that documents issued by EC, OECD etc. stress that climate change and demographics are not adequately considered in the analysis of the sustainability of public finances – and analyzes of the European Fiscal Board point to this situation.

The subsequent analysis highlights, among other things:

- the situation of the domestic tax regime in comparison to other EU countries – tax and collection rates, with estimates of possible additional tax revenues (***Annex B*** illustrates approaches in Europe on rethinking tax systems);
- the state of tax revenue collection – tax bases, exceptions and exemptions that erode possible revenues and what can be done in this regard;
- the situation of property and environmental taxes and the causes of the loss of tax revenues in these areas;

[3] In many EU countries it has been decided to increase defense spending; in Romania, these expenditures will increase from 2% to 2.5% of GDP

- digitalization as a means to help the reform of NAFA, to improve the collection of tax revenues, which, however, presumes the political will to confront interest groups that want to maintain the current system.

The last section is devoted to conclusions and recommendations for rethinking the tax regime. A key message of the analysis is that **tax revenues in Romania must increase towards the average in Central and Eastern Europe for the public budget to meet current and future very high needs**. This message is also supported by the conclusions and recommendations of some international institutions and of the European Commission (see also ***Annex B***).

It must be reiterated that it is necessary to remove from the public discourse the offers to reduce tax rates in a period when the consolidated budget is under extraordinary pressures, just as it is also necessary to give up promises that are impossible to finance, such as those that lead to a significant increase in various permanent expenditures. Punctual and temporary interventions are not excluded, they may be necessary under very difficult conditions, but their permanence and generalization must be avoided.

The budget adjustment calls for a reduction in the budget deficit, according to ESA 2010 methodology, from approx. 7.2% of GDP in 2021 to below 3% of GDP in a few years – the ambitious target set by the Government being 2024. If we had a much better tax collection (with a substantial increase in VAT revenues) and with a massive reduction of exceptions and exemptions, much of this correction would be possible.

The first front of urgent action concerns the significant reduction of tax evasion and the elimination of exceptions and exemptions, implicitly a major improvement in the collection of taxes and duties in the coming years. Such an action takes into account the current context, marked by a slowdown in economic growth, the energy crisis, the war in Ukraine etc., a context that does not allow the increase of tax rates for taxpayers that do not benefit from exemptions. Depending on the circumstances, additional measures to balance the public budget may be considered, such as an increase in environmental or property taxes.

The alternative to not significantly increasing tax revenues in order to reduce the budget deficit is to drastically reduce spending (by a few percentage points of GDP), which is an equation that the members of the Group consider impossible to solve. This does not mean that the efficiency of public spending is not necessary/possible, but we believe that it could mean a better allocation of these expenditures (which would increase the quality of public services, that many taxpayers claim to be insufficient) and not necessarily their reduction.

The avalanche of new challenges requires consideration of the following: (i) most of the budget consolidation will have to be done on the revenue side; (ii) any new legislative proposal for fiscal relaxation will make the adjustment process much more difficult; (iii) the phases of budget revenue growth will need to be updated, in the sense of issuing new legislation during 2022 and implementing it starting in January 2023.

If the recommendations of this study were implemented, fiscal revenues (including social security contributions) could increase by about 3.7 to 4.7 percent of GDP over the time taken to correct the budget imbalance. Of this increase, about half would come from the elimination of discriminatory exemptions and treatments (especially at the level of corporate income tax, personal income tax and social security contributions), about a third – from improved collection (especially at the level of VAT), including through the digitalization of NAFA, and about a sixth – from increasing tax rates (especially for environmental and property taxes). Such an increase would allow the budgetary correction that is necessary in order to exit the Excessive Deficit Procedure (EDP) and, especially, the improvement of Romania's financial robustness, the sustainability of public debt.

But we must also take into account other adverse shocks related to climate change, demographics, energy transition, which require additional own resources for the budget.

A considerable increase in tax revenues cannot be achieved in the short term, it takes several years. And it is to be admitted that the year 2022 is very complicated by the overlapping of crises and the prospect of a strong slowdown in economic growth, which requires attention in the process of rethinking the tax regime. But budget consolidation is absolutely necessary.

The rethinking of the tax regime must take into account key issues regarding transparency, fairness, the correct distribution of the burden of adjustments to various adverse shocks, solidarity, encouraging labor market participation, encouraging compliance with payment and fulfillment of obligations, discouraging tax evasion and tax arbitrage etc. It is not fair for entire fields of activity or social classes to be treated preferentially and for aggressive tax optimization to be allowed through various loopholes left in the tax legislation.

Consolidating the public budget is a process that will take several years and will take into account the evidence, the answers of the economy. It is desirable for the economy not to be exposed to abrupt measures, especially in very difficult times. On the other hand, there are features of the current tax regime that can and should be corrected as soon as possible.

Among economists, there has long been a concern to carry out more in-depth analyzes of the domestic tax regime, that should try to imagine ways to rethink it, to increase tax revenues. The stated desire of some economists and other experts to get involved in a concrete analysis met with the thoughts of the Romanian Fiscal Council. This resulted in the establishment of a Working Group consisting of Gabriel Biriş, Bogdan Căpraru, Delia Cataramă, Radu Ciobanu, Adrian Codîrlaşu, Bogdan Cozmâncă, Georgiana Georgescu (Crețan), Cristian Cucu, Daniel Dăianu, Iuliana Dascălu, Ionuț Dumitru, George Georgescu, Valentin Lazea, Dan Manolescu, Constantin Marin, Călin Rangu, Răzvan Stanca, Leonard Uzum, Lucian Țâțu, Liviu Vidrașcu.

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Chapter 1 - International comparisons of tax rates and tax revenue collection

Romania entered in 2019 in the group of high-income countries[4], respectively of those countries that have a GNP/inhabitant of over 12,695 dollars[5]. Moreover, our country has recently renewed its efforts to be received in the OECD, the organization of highly developed states. In terms of GDP/inhabitant expressed at the Purchasing Power Standard (PPS), Romania recorded in 2020 a level of 72% of the European Union average, at a short distance from Hungary (74%) or Poland (76%), but well above Bulgaria (55% of the EU average)[6].

Under these circumstances, the extremely small share, especially by European standards (ESA 2010), of fiscal revenues (26.3% of GDP in 2020), compared to 35.7% in Poland or 36.3% in Hungary and even Bulgaria (30.6% of GDP) [7] is unnatural. In this sense, see Table 1 (***Annex C***). An analysis of the data for previous years (2016-2019) - Tables 1b-e (Annex C)- reveals that Romania ranks last among the countries chosen for the comparative analysis, at a distance of at least 3.3 percentage points and a maximum of 4.9 percentage points from Bulgaria (the state with the lowest share of tax revenues in GDP in the group: Bulgaria, Czechia, Poland and Hungary), respectively at a distance of at least 10 percentage points and a maximum of 13.2 percentage points from Hungary (the state with the highest share of tax revenues in GDP of the group: Bulgaria, Czech Republic, Poland and Hungary).

The very low level of fiscal revenues is caused by three distinct factors (or their combination): a low collection of taxes and fees due, including due to a large informal economy; a multitude of exemptions and exceptions that deplete the tax base, as well as preferential tax regimes in some sectors of activity and for certain categories of taxpayers; in some cases, very low tax rates compared to those in the central and eastern European states. A detailed analysis of these three groups of factors can be found in the following chapters of the paper.

In this chapter we will present an analysis at aggregate level, trying to identify the types of taxes and fees for which Romania collects significantly fewer fiscal revenues than the states of Central and Eastern Europe (CEE).

In order to carry out the analysis at aggregated level, we will use Eurostat data, summarized in three tables (***Annex C)***.

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[4] As defined by the World Bank https://datatopics.worldbank.org/world-development-indicators/the-world-by-income-and-region.html. It should be noted that the threshold changes every year on July 1, the last announced being on July 1, 2021

[5] It is true that in 2020, as a result of the Covid 19 pandemic, Romania temporarily relegated to the group of "upper middle income" countries, but in 2021 it returns to the group of "high income" countries.

[6] Data published by Eurostat. See Annex C.

[7] It can be argued that, as 2020 is affected by the pandemic, budget revenues are distorted. But the data provided by Eurostat for 2019 does not differ much: 26.0% of GDP for Romania, 36.4% for Hungary, 35.1% for Poland and 30.3% for Bulgaria.

Some conclusions can be drawn from Table 1a (***Annex C***):

a) Romania registered, in 2020, a fiscal revenues gap of about 4 percent of GDP compared to Bulgaria and about 9 percent of GDP compared to Poland and Hungary. If – as would be normal – the reporting is made to the latter countries, Romania should aim to increase its fiscal revenues to approximately 35-36% of GDP in the medium and long term. It is obvious that only through a better collection of the amounts due to the budget the respective fiscal the gap will not close, as it is necessary to eliminate some exemptions, exceptions and preferential regimes while, where appropriate, to increase some tax rates that are considerably lower than the European standards or compared to the countries of Central and Eastern Europe;
b) Regarding direct taxes, the fiscal gap of about 3 percentage points of GDP compared to Poland and Hungary, respectively of about 1 percentage point of GDP towards Bulgaria, can be attributed mainly to personal income tax. Romania has the lowest statutory rate, of 10%, similar to Bulgaria (although it collects significantly more), but below the statutory rate in Hungary, of 15%, not to mention Poland (marginal rate 32%). See, in that regard, Table 3a (***Annex C***). The high share of income from insurance contributions owed by employees (related to gross wages) correlates with lower personal income tax receipts, as these are deductible from the gross wage;
c) The revenues from corporate income tax and other direct taxes seem to be in line with the peers (even if Bulgaria also collects marginally better here). To a large extent, the collection rate in Romania is negatively influenced by the way in which micro-enterprises are defined and taxed (1% of the annual turnover below 1 million euros) and by the replacement of the corporate income tax with the specific tax for the HoReCa sector;
d) As regarding indirect taxes, the biggest problem is found at the VAT level, where Romania collects about 3 percentage points of GDP less than the peers. The problem is due less to statutory VAT rates of 19% and, respectively, 9% or 5% (reduced rates). They appear to be similar to those in Bulgaria (20/9%), although it collects 3 percent of GDP more than Romania. It is true, however, that in Poland and Hungary the statutory VAT rates are significantly higher (23/8/5 and 27/18/5 respectively, according to Table 3a (***Annex C***)). In Romania's case, the problem is amplified by the low grade of collection, but also partly by the wide scope of application of the reduced rates;
e) Other indirect taxes where Romania collects significantly less than the peers are taxes on products (excluding VAT and taxes on imports), respectively, other taxes on production;

f) A special discussion is required by the revenues from social security contributions (SSC). Although the insurance contributions paid by employees seem disproportionately higher than in other states, this is due to the legislative changes from 2017 (which became operational on January 1, 2018), which moved the tax burden almost entirely on the shoulders of the employee, a unique practice amid all other countries. Overall, however, revenues from SSC, at 11.1 percent of GDP, appear to be in line with those in Poland and Hungary and slightly above those in Bulgaria. Certainly, Romania collects weaker than the other states given the statutory rates for insurance contributions (37.25%, versus 33% in Bulgaria, 36% in Hungary, 40.6% in Poland, almost 45% in the Czech Republic).

With regard to the economic structure of taxes and fees, presented in Tables 2a-e (***Annex C***), as well as to the implicit tax rates[8] presented in Tables 3a-e (***Annex C***), the following general comments can be made:

a) consumption is under-taxed in Romania, compared to all other countries. GDP growth on account of the consumption stimulus, favored by all Romanian governments since 2015, has led to the exacerbation of imports and to a large current account deficit (7% of GDP in 2021), far outside the European benchmarks. As seen in Table 3a (***Annex C***), the implicit rate of consumption taxation in 2020 is 15% in Romania, compared to 19% in Poland, 26% in Hungary or 21% in Bulgaria. It should be noted that this low level does not necessarily reflect the taxation rate, but the low degree of compliance;
b) labor taxes are a result of the addition of insurance contributions revenues (roughly similar in percentage of GDP to the peers) to those from personal income tax (much lower in the case of Romania). The resulting 13 percent of GDP is lower than in Poland (14.4 percent of GDP) or Hungary (16.3 percent of GDP), even though it is higher than in Bulgaria (11.5 percent of GDP). In fact, as shown in Table 3a (***Annex C***), the implicit labor tax rate for 2020, in Romania (31.1%)[9] is lower than in Poland (33.9%) or in Hungary (38.2%), but above that in Bulgaria (25.4%). We analyze in Chapter 2 the various exemptions/exceptions to taxation that may have this effect of a lower implicit tax rate on labor;
c) and capital is under-taxed in Romania compared to the peers, especially in terms of taxes on self-employed income (this includes the insurance contributions of self-employed,

[8] The implicit rates of consumption, labor and capital taxes are calculated by the European Commission. The methodology is available here: https://ec.europa.eu/taxation_customs/system/files/2021-06/ttr_methodolgy_2021.pdf
[9] The average is lowered by exemptions from paid work (Construction, IT).

which have the tax base capped at the minimum wage) and taxes on capital stock. In 2019[10], the implicit capital tax rates show that in Romania the taxation of capital (10.1%) is much lower than in Poland (23.4%) or Hungary (13.7%)[11];

d) regarding the environmental taxes, if energy taxes were, in 2020, at similar levels to those in the peers[12], instead, for taxes in transport (excluding taxes on fuel) and pollution taxes, Romania has a gap, as shown in Table 2a of ***Annex C***;

e) finally, property tax receipts are significantly lower in Romania, not so much in terms of recurring taxes on real estate, but for other property taxes, as shown in Table 2a, ***Annex C***.

To put it briefly, for all five types of taxes and fees in economic structure (on consumption, on labor, on capital, on environment, respectively on property), Romania collects less – sometimes significantly less – than Poland or Hungary, states at a similar level of economic development.

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[10] The last year for which there are data for implicit capital tax rates is 2019

[11] Source: Taxation Trends in the European Union 2021, https://op.europa.eu/en/publication-detail/-/publication/d5b94e4e-d4f1-11eb-895a-01aa75ed71a1/language-en

[12] But likely to decline in 2022 as a result of recent legislative changes.

Chapter 2 - Analysis of tax revenue collection - size, setting, problems and solutions

As shown in Chapter 1, the fiscal revenues of the state budget, including the social security budget, are at a very low level, both compared to the EU average and to neighboring states, in some of them (i.e., Bulgaria) the standard tax rates being even lower than in Romania. Romania is subject to the excessive deficit procedure and must follow a fiscal consolidation program[13]: from 9.35% in 2020 (headline deficit in ESA 2010) to 8.03% in 2021, 6.24% in 2022, 4.40% in 2023, 2.90% in 2024 and 2.02% in 2025, while both the funds provided to the NRRP and by the EU cohesion funds depend on compliance with this timetable (Art. 10 of EU Regulation 2021/241, Article 19.7 of EU Regulation 2021/1060)[14]. To what extent the war in Ukraine and the energy crisis can "shape" the trajectory of the adjustment is to be seen. But it is certain that this correction must take place.

Before analyzing the tax revenues on each main component (profit tax / microenterprise income tax / specific tax, income tax and insurance contributions, VAT, excise duties, local taxes), we make some preliminary comments:

i) the tax revenue generated by a tax is the result of the product between the tax base and the tax rate(s);
ii) the tax base can be reduced mainly by two methods:
    (a) exemptions, reductions or alternatives granted by the legislator, and
    (b) evasion;
iii) the different types of taxes are inter-conditioned, and the impact of the fiscal measures must also be seen in the light of the principle of communicating vessels: the high pressure (high tax) on one of the vessels will cause the liquid (the taxable mass) to be pushed onto the other vessels (low taxes or exemptions);
iv) in order to be effective, any public policy needs as much acceptance as possible at the level of the population (voluntary compliance), so that the enforcement costs are as low as possible. The lack of effective enforcement will obviously lead to a decrease in compliance over time;
v) both to ensure voluntary compliance and effective enforcement with reasonable costs, the (tax) law must be as simple as possible to understand, but also hard to avoid.

Also, for a better understanding, we present in the following table (Table no. 1) the total tax burden borne by a taxpayer (final beneficiary, individual) depending on the type of income obtained:

[13] MoF report on the macroeconomic situation for 2022 and its projection for 2023 - 2025, page 8.
[14] However, it is possible that the war in Ukraine will influence the judging framework of the NRRP, as it will be in other states that benefit from NGEU resources.

Table no. 1. The total tax burden borne by an individual taxpayer, depending on the type of income

Nr.	Type of income	Total tax burden ****) (%)
1	Salary, no exemptions	43.75
2	Salary with tax exemption (IT employees, R&D employees, HoreCa seasonal employees)	37.25
3	Salary with exemption from payroll tax, HSC, without contribution to Pillar II (employees in construction / construction services / production of construction materials)	23.5
4	Income from self-employed *) **)	10
5	Income from self-employed - including SSC, HSC	3
6	Rental income **)	6
7	Copyright revenue*) **)	6
8	Earnings from the transfer of securities **)	10
9	Dividend income/LP 16% **)	20.2
10	Dividend income/ LP 1% **) ***)	3.5
11	Dividend income / LP 3% **) ***)	5.5
12	Dividend income / LP 0% **) ***)	2.5

Note:
*) For self-employed, SSC = 2,550 * 12 * 25% = 7,650 lei / year must be added.
**) For persons earning income from self-employment, rents, dividends, other income, HSC = 2,550 * 12 * 10% = 3,060 lei must be added.
***) For micro-enterprises or companies that do not pay profit tax, own expenses of 50% of the income have been estimated
****) The tax burden is calculated as total taxes and insurance contributions / gross income.

There is a huge gap between the lowest and highest tax burden, which generates a stimulus for tax planning, which is a right granted by law (which distinguishes between different taxation by type of income / types of companies). Obviously, the legislation also includes anti-abuse measures, but their application involves a number of significant administration costs, and the limitation period limits these actions in time. In addition, the tax restatement during the inspection often results in long-term tax disputes, which involve other costs, both for the taxpayer and for the tax authorities.

In the following will be analyzed, what we consider to be the main problems in the regulation of each type of tax and will propose solutions starting from the thesis that the **tax burden should not be depend on the type of income, but only on its size, without privileges or discrimination**.

2.1. Corporate income tax/Microenterprise income tax/Specific tax

2.1.1. Current situation

As can be seen from Table no. 2, the revenues planned to be collected to the state budget from corporate income tax has decreased significantly since 2016, from 1.89% of GDP to 1.56% of GDP in 2019 and up to 1.46% of GDP in 2021, although economic growth should have also resulted in a certain increase in profitability and, therefore, in higher revenues from the profit tax collected to the state budget.

Table no. 1. Revenues planned to be obtained from corporate income tax and microenterprise income tax

	2016		2019		2021	
	Budget law (thousand lei)	**% of GDP**	**Budget law (thousand lei))**	**% of GDP**	**Budget law (thousand lei)**	**% of GDP**
Corporate income tax	14.331.284	1,89%	15.916.594	1,56%	17.388.366	1,46%
Microenterprise income tax	553.119	0,07%	2.644.929	0,26%	2.668.958	0,22%
TOTAL	14.884.403	1,96%	18.561.523	1,82%	20.057.324	1,68%

Source: State Budget Law, GDP estimated at the drafting of the State Budget Law.

This was caused by the removal of two large categories of taxpayers from the scope of corporate income tax, representing approximately 90% of the total number of active companies, as shown in Table no. 3:

i) Medium and large companies operating in the HoReCa sector, the corporate tax being eliminated in 2016 (starting with 2017) and replaced by a specific tax, derisory in most cases. The specific tax was provided for in the state budget law at a level of only 0.0129% of GDP in 2017, and in 2021, as a result of the COVID pandemic, at only 0.0037% of GDP. It should be noted that the measure was adopted in full economic boom (2016), and the HoReCa sector benefited simultaneously in the same period from the VAT reduction from 19% to 9% (2015) and subsequently to 5% (2017), as well as from the boosting of the consumption growth in the field by granting holiday vouchers;

ii) Raising the ceiling for the application of the income tax on micro-enterprises from 100,000 euros / year to 500,000 euros and then to 1,000,000 euros / year in 2017. Taking into account that the limitation regarding to consultancy and management activities has also been eliminated and that no provisions have been introduced to limit splitting the business in several companies, the measure has removed from the scope of the corporate income tax over 90% of companies, which in turn, pay the 1% tax on turnover (3% if they have no employees), a tax rate equivalent to the 16% tax rate paid by a company that obtains a profit margin of 6.1% (6.1%*16%=1%). The evolution of the revenues planned to be collected from this tax is presented in Table no. 2. However, the significant increase in revenues received from the micro-enterprise income tax is misleading, this increase being at the expense of (i) the corporate income tax, the number of companies paying corporate tax (16%) decreasing dramatically as a result of raising the ceiling from 100,000 to 1,000,000 euros and (ii) of PIT and SSC, HSC, as removing restrictions on consulting and management by migrating to micro-enterprises both salaries (in whole or in part) and individuals who earn income as self-employed.

Table no. 2. Evolution of the number of taxpayers paying corporate tax versus income tax on micro-enterprises

	2015		**2016**		**2019**		**2021*)**	
	Number	**Share**	**Number**	**Share**	**Number**	**Share**	**Number**	**Share**
Profit tax payers	223.659	31,13%	196.772	28,4%	115.987	13,19%	119.746	12,32%
Micro-enterprise income taxpayers	494.748	68,87%	494.993	71,56%	763.409	86,81%	852.046	87,68%
TOTAL	718.407	100,00%	691.765	100,00%	879.396	100,00%	971.792	100,00%

Source: ANAF fiscal statistical bulletin
*Note: *) For quarter III 2021*

The aggregate impact of these measures has led to a decrease in these direct tax revenues from 1.9623% in 2016 (planned) to 1.6888% in 2022 (estimated), given that in the period 2016-2021 (with except 2020) we have had significant GDP increases.

2.1.2. Possible solutions

Given that the regulation of corporate taxation in the Fiscal Code is relatively modern, which includes the regulation of transfer pricing, permanent establishments in line with OECD regulations, it is clear that the main solutions to increase budget revenues from corporate tax are even the elimination measures which have led to their reduction:

i) elimination of the specific tax[15] and return to the profit tax, especially since this regulation applies only to medium or large hotels and restaurants (some very large), with an annual turnover of over 1 million euros, the rest being subject to income tax micro-enterprises);

ii) keeping the income tax of micro-enterprises as a simplified form of taxation of small and very small businesses, but in conjunction with:

  a) **immediate** reduction of the turnover ceiling to a level comparable to that up to 2016;
  b) limiting the use of this simplified regime for activities such as consulting, management (as it was before 2017), but also for other activities related to the exercise of free professions or for intermediation activities;
  c) limiting the number of companies that apply the simplified regime in which a person can be a majority partner, in order to avoid the artificial division of income between several companies.

Unlike other taxes (i.e., income tax, insurance contributions), taxpayers subject to corporate tax do not benefit from exemptions or reduced rates, with one exception whose usefulness is worth reconsidering: the exemption from corporate tax, for a period of 10 years (from 2017) of taxpayers who carry out exclusively innovation, research and development activity. It is at least strange for a taxpayer who does exclusively such activities (most often as a service to a beneficiary, who will also own the intellectual property rights), to benefit from the exemption, but a taxpayer, who invests in research and development, the results of which (patentable or not) he subsequently uses in his own production, does not benefit from the exemption, not realizing revenues exclusively from research and development. The latter theoretically have the possibility to benefit from an additional deduction of 50% of the R&D expenses, but this deduction is inapplicable in practice being conditioned by the validation of R&D projects by a specialist from a register, which is non-functional[16].

The budgetary impact of implementing these measures is difficult to calculate, but given previous developments, we estimate a significant positive impact (**around 0.5% of GDP**) [17]), without

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[15] In principle, the exemptions from the application of corporate income tax, namely micro-enterprise income tax and specific tax, should apply only in those situations where the collection effort is greater than the establishment of corporate income tax.

[16] Order 350/2019 of the Ministry of Research and Innovation approves a register of 26 experts who should check all projects in the country, but no one knows how these experts can be contacted, where and by what procedure and in what fields they are experts, for the list contains only the name of the expert and the institution where he works.

[17] Taking into account an average income tax on micro-enterprises of 1.5%, the revenues scheduled to be realized from the income tax on micro-enterprises in 2022 (3,665,291 thousand lei, according to Law 317/2021 on the state budget for 2022), taking into account an average profit margin of at least 25% of turnover, it results that the elimination of the micro-enterprise income tax could increase the revenues from the profit tax by 9.78 billion lei (6.1 billion net). To this amount is added an additional impact on the increase in corporate income tax from the elimination of the specific tax of at least 1.5 billion lei and, taking into account that it is not proposed to completely eliminate the income tax on micro-enterprises, we

taking into account the impact of limiting the use of the simplified tax regime on micro-enterprises on PIT, SSC and HSC.

Such a set of measures would ensure that a competitive profit tax rate is maintained to attract / retain investors in Romania, even if some of the neighboring countries currently have significantly lower profit tax (e.g., Bulgaria 10%, Hungary 9%). However, these countries are expected to be forced to raise their taxes so that they do not fall below the 15% threshold recently regulated by GloBE by the OECD.

In addition, the proposed measures would also ensure what most business people have long called for: the 'level playing field', which means equal treatment between different categories of investors.

2.2. Personal income tax/Social security contributions/Microenterprise income tax

2.2.1. Current situation

In the case of personal income tax and insurance contributions, in 2018 a reform was implemented, mainly aiming at increasing the revenues of the Social Insurance Budget. Below, Table no. 4 presents the revenues planned to be obtained from personal income tax and insurance contributions in 2016, 2019 and 2021 according to the budget laws.

Table no. 3. Planned revenues from personal income tax and insurance contributions

	2016		2019		2021	
	Budget law (thousand lei)	**% of GDP**	**Budget law (thousand lei))**	**% of GDP**	**Budget law (thousand lei)**	**% of GDP**
Personal income tax	25,871,374	3.41%	23,560,790	2.30%	26,166,190	2.34%
Insurance contributions	38,041,851	5.01%	71,689,581	7.01%	73,504,857	6.58%
TOTAL	**63,913,225**	**8.42%**	**95,250,371**	**9.31%**	**99,671,047**	**8.92%**

Source: State Budget Law, GDP estimated at the drafting of the State Budget Law.

By implementing the reform, it was possible to attract additional resources to the Social Insurance Budget, but their cumulative increase was only 1% of GDP (in 2019 compared to 2016), while 2021, affected by the pandemic, experienced their decline.

can estimate a positive impact of the profit tax, cumulated with the income tax of micro-enterprises, of at least 0.5% of GDP (6 billion lei).

The present regulation for personal income tax (of which the payroll tax has the largest share) and that of insurance contributions currently create the largest discrepancies between the total tax burden for the various categories of employees, self-employed and persons employed in companies applying the tax regime of micro-enterprises. The use of micro-enterprises has increased, especially after the abolition of the constraint for consulting and management activities in 2017 (introduced in 2007), and also after the increase of the ceiling to 1 million euros and, with the introduction (correct, by the way) in 2020 of the possibility to make quarterly dividend distributions.

It should be noted that - although they are regulated in the Fiscal Code since 2010, insurance contributions are payments that involve a number of benefits (number of pension points and other social insurance benefits, health insurance). Pension contributions (SSC) are mainly based on solidarity and intergenerational equity (with the exception of Pillar II, where a share - 3.75% of the total contribution of 25% that feeds individual, privately managed accounts) and HSC on the principle of solidarity between existing taxpayers, the contribution being calculated by reference to the tax base. However, being included in the Fiscal Code, they are seen as taxes, and tax optimization schemes often aim to avoid paying insurance contributions.

An individual with income from salaries has a standard personal income tax rate of 10%, while a micro-enterprise owner without employees will be subject to a standard tax rate of 8% (3% micro tax + 5% dividend tax[18]). The difference does not seem to be large, however, while the employee is subject to 35% insurance contributions applicable to income, dividend income is subject only to HSC but limited at applying the 10% up to 12 minimum wages per year.

3.2.1.1. Tax rates

Romania currently has the following income tax rates and insurance contributions:

- SSC (state social contribution) - 25% of the tax base;
- HSC (health social contribution) - 10% of the tax base;
- PIT (personal income tax) - 10% of the tax base, minus SSC and HSC (as applicable), for most categories of income (salaries and similar to salaries, self-employed, rents, royalties, earnings from the sale of securities, participation, other income);
- Dividend tax - 5%;
- - Income tax from the transfer of real estate from personal patrimony: 3% for what exceeds 450,000 lei /real estate.

[18] The tax rates apply to different tax bases. By bringing it to the same tax base, the tax would be about 7.85%.

However, the Fiscal Code also includes exemptions, as follows:

- IT programmers (not the rest of the staff), are exempted from payroll tax - since 2001;
- employees in research and development activities, are exempted from payroll tax salaries, starting with 2017;
- seasonal employees of HoReCa companies, are exempted from payroll tax since 2017;
- persons with severe disabilities, are exempted from paying PIT and HSC on wages, on self-employed income or on copyright;
- employees in construction companies, construction services as well as companies producing construction materials and equipment, are exempted from PIT, HSC and the contribution to the Second Pension Pillar (3.75%) - since 2019, for a period of 10 years;
- persons that have revenues from copyright are excepted from paying SSC, HSC, if they also concluded an employment contract.

3.2.1.2. Tax base

The Fiscal code also provides major differences in the tax base for:

- for persons who obtain income from salaries and assimilated to salaries, the calculation basis of CAS, CASS is the gross salary, without any cap, on each salary separately. An individual CAS cap (10.5%) existed until January 2017 (at 5 average salaries, correspondingly there is also a cap on the number of pension points at 5, even if the employer CAS - 15.8% was practically not capped), when it was removed (the ceiling of the pension point was also removed);
- for self-employed persons, the calculation basis of the CAS is equal to the minimum wage per economy, optionally the base may be increased;
- for persons earning income from self-employment, rents, dividends, capital gains or income from other sources, the calculation basis of CASS is equal to the minimum wage (12 minimum wages / year), cumulated, on all types of income;
- for self-employed persons whose income tax base is based on income tax, the income tax base is the income standard, i.e., the minimum wage for CAS, CASS. It should be noted here that these revenues include IT revenues, where the income standard is close to the minimum wage (37,000 lei / year), provided that the income does not exceed 100,000 euros / year;
- for persons who obtain income from intellectual property rights (copyrights), CAS and CASS are not due if they also have the quality of employees. Here it was observed that, for reasons of tax optimization where possible (content creation, press, etc.), companies hire a person with

a minimum wage in the economy (maybe even part-time), the rest of the amounts being given on assignment contracts. copyright, thus eliminating CAS and CASS payments to an activity that is often purely dependent.

These huge differences (shown in Table no. 1), combined with the very light regulation of the micro-enterprise income tax, make the degree of voluntary compliance in the case of high and very high salaries relatively low (only about 100,000 salaries - less than 2% of the total, exceed 3 average salaries, of which about 50,000 exceed 5 average salaries, including salaries and incomes assimilated to salaries in the public system).

In addition to the loss of revenue to the consolidated budget generated by "adapting" to more favorable legislation, this system calls into question the very principle of solidarity underlying CAS, CASS, creating privileges for some taxpayers and frustration among taxpayers who cannot benefit from these privileges. This frustration is also amplified by the fact that, although there are legal provisions that should prevent the abuse of rights, the legislator chose to offer tax amnesties when he found that his legislative texts generated various tax behaviors with systemic impact (Law 209/2015, Law 72/2022, currently in Parliament being another such initiative, B139 / 2022), but also by the numerous provisions for the cancellation of the calculated accessories. Thus, the right taxpayers end up wondering why they still pay taxes and insurance contributions in a state where it is the order of the day that when you do not pay them to benefit from tax amnesties and cancel the accessories for non-declaration and / or non-payment tax obligations.

2.2.1.3. Observations

i) In what regards "The Fiscal Revolution"

It is necessary to clarify the current tax rates, in force since 2018, after the so-called "fiscal revolution" took place in 2017.

In 2017, we had the following tax rates:

- Personal income tax/salaries– single rate of 16% (unchanged from 2005);
- CAS – 10,5% (employee) + 15,8% employer (from the salary fund);
- CASS – 5,5% (employee) + 5,2% employer (from the salary fund).

"The fiscal revolution" adopted by GEO 79/2017 (not yet approved by law), eliminated the employer's insurance contributions and increased the employee's insurance contributions, with employers in turn increasing their gross salaries, generally by 21% (15.8% + 5.2%), so that the net salary of the employees does not decrease.

For this transfer to be neutral, CAS would have to be 21% (compared to the 25% rate adopted) and CASS 8.8% (compared to the 10% rate adopted), and the income / salary tax should remain 16% (reduced to 10% to compensate for the increase in CAS, CASS). The practical effects were as follows:

- the tax burden on income from salaries was maintained;
- the total tax burden for self-employed income (which also benefited from the establishment of CAS and CASS at the minimum wage), rents, earnings from the transfer of shares, interest and other income was significantly reduced;
- approximately 11 billion lei were transferred relatively arbitrarily from the State Budget (income tax reduction) to the Social Insurance Budget (CAS increase), an amount which was later used to support the accelerated increase in pensions)[19].

ii) Regarding the administration of personal income tax

Personal income tax administration is extremely cumbersome. Thus, the Fiscal Code defines 10 categories of personal income tax, each with a different way of setting, calculating and declaring the tax. According to the Fiscal Code art. 61, the income categories are:

"a) income from independent activities, defined according to art. 67;

a[1]) income from intellectual property rights, defined according to art.70;

b) income from salaries and assimilated to salaries, defined according to art. 76;

c) revenues from the transfer of the use of the goods, defined according to art. 83;

d) investment income, defined according to art. 91;

e) pension income, defined according to art. 99;

f) income from agricultural, forestry and fish farming activities, defined according to art. 103;

g) revenues from prizes and games of chance, defined according to art. 108;

h) income from the transfer of real estate, defined according to art. 111;

i) revenues from other sources, defined according to art. 114 and 117."

Moreover, even within the same income category, there are different methods of calculating, declaring and paying taxes, such as:

[19] The figure results from the comparison of the revenues estimated to be realized from the income tax in 2018 (33,446,941 thousand lei, according to Law 6/2017 on the state budget for 2017, prior to the "fiscal revolution") and of the revenues estimated to be realized from the income tax income in 2018 (22,351,919 thousand lei, according to Law 2/2018 on the state budget for 2018, - 11.1 billion lei, following the "fiscal revolution"). The difference is found entirely in the increase of revenues from CAS (estimated at 46,510,569 thousand lei for 2018 according to Law 7/2017 on the social insurance budget for 2017 and 59,322,864 thousand lei according to Law 3/2018 on the Social Insurance Budget for 2018, ie +12.8 billion lei).

- in the case of income tax from independent activities, there are differences between the tax calculated in real system, with income norms or by withholding tax for sports activities;
- for income tax on the transfer of the use of goods, the tax is calculated differently for rental income, income from renting rooms for tourist purposes, other rental income for which tax may be applied at a flat rate or in real system, rents in foreign currency they have a different declaration system than the rents in lei, etc.;
- there are different systems and quotas for investment income tax for: dividends, interest, earnings from the transfer of equity securities, etc.

Thus, the degree of complexity in determining the tax owed by a natural person is much higher than that of legal entities. Hence the multiple mistakes that generate an additional burden on the administrative system. Suffice it to say that the instructions for completing the Single Declaration form (declaration number 212 declaring all income other than salary and withholding tax) are 64 pages long.

NAFA, on the other hand, keeps track of individuals at the NPC level, using very cumbersome software and which is often incomprehensible even by those who use it. In the record of payment obligations, the software does not automatically compensate the payment amounts with the amounts paid in addition, most taxpayers having in these files both amounts to be paid and amounts paid in addition, but receiving enforceable titles and summonses for amounts that appear as unpaid.

iii) Other observations

It should also be noted that the current Fiscal code / Fiscal procedure code:

a) regulates very briefly extremely dynamic sectors, that of virtual currencies (crypto currencies) and that of NFT (non-fungible tokens);

b) does not contain any provision regarding the obligations of final beneficiaries (UBO) in foreign companies located in tax havens (CFC Rules for UBO);

c) regulates inefficiently the verification and taxation (only with the standard tax rate - 10%) of the amounts that cannot be justified by the taxpayer. Taxation with the standard rate of amounts that cannot be justified during tax audits also sends a fundamentally wrong message to the taxpayer "the caught thief (prescription, lack of verification, etc.) is an honest merchant, the caught thief pays like the „honest merchant";

d) establishes that the taxation at the level of natural person is made for each "source" of income, without defining what this source represents [20].

[20] See analysis at https://economie.hotnews.ro/stiri-finante_banci-25143546-dan-manolescu-persoanele-fizice-nevoie-desfiintare-sursa-impozitul-venit-problema-mare-legislatia-gaurita.htm

2.2.2. Possible solutions

Based on the above principle - the tax burden determined by the size of the income and not its type - and taking into account that CAS, CASS are not taxes (but payments involving a series of social and health insurance benefits), we consider that several objectives can be achieved simultaneously (increase of revenues to the consolidated budget, elimination of privileges, but also decrease of the obligations assumed for the future by the State Social Insurance Budget), adopting the following set of measures:

i) establishing the tax base of CAS and CASS at the level of **all** incomes (which are included in the tax base of these contributions) obtained by a natural person;

ii) capping the tax base of CAS, CASS at a reasonable level (maximum 3 average salaries per economy per month, respectively 36 average salaries per economy per year), calculated for the amount of income corroborated with the corresponding capping of the number of pension points. The capping of the CAS, CASS tax base at 3 average salaries per economy is conditioned by the simultaneous implementation of the measures proposed in point iii), a partial elimination of exemptions necessitating a revaluation of this amount to a higher level, in order to avoid lower revenues. to the consolidated budget;

iii) the elimination of all exemptions and preferential treatment (for different categories of employees or taxpayers from various sectors of activity) created by establishing different tax bases for CAS, CASS (minimum wage) or income tax (income standard);

iv) the elimination of the reduced rate of taxation of dividends and the application of the standard rate of taxation of 10%;

v) introduction of CFCs for UBO (undistributed profits from companies in weak / untaxed tax jurisdictions treated as dividends);

vi) introducing effective measures to facilitate the imposition of amounts that cannot be justified by declared income and discouraging the accumulation of such amounts in the future;

vii) clear regulation of earnings from transactions in virtual currency or NFT, similar to the current way of taxing the gains obtained from trading on regulated markets of equity securities;

viii) revision of the calculation method of the tax for the income obtained from the sale of real estate from personal patrimony, so that (i) to allow the deduction from the value of the transaction of the amount of 450,000 lei only in the case of the first dwelling (from the second dwelling purchased operates no deduction); and (ii) exempt from taxation only transfers between relatives or first-degree relatives (parents, children, spouses), taxing all others.

Alternatively, and preferably, the possibility of taxing the gain from the sale of real estate from personal property may be considered, applying the following rules:

- o taxation of 10% of the profit obtained from the sale, this being determined as the difference between the sale price and the tax value of the real estate sold, minus the expenses occasioned by the sale;
- o exemptions: only a residential property for 3 years, as well as donations between relatives and relatives of the 1st degree (with the preservation of the tax value prior to the donation).

ix) reduction of the ceiling for which the activity can be taxed on income norms from 100,000 euro to 20,000 euro;

x) digitization and simplification of the income tax return system by individuals.

The capping of the CAS, CASS tax base and the elimination of exemptions / preferential treatments must MUST be done TOGETHER!

(i) The capping of the CAS and CASS tax base without the elimination of exemptions will result in a significant reduction in consolidated budget revenues, with a partial elimination of exemptions necessitating a capping at a higher than proposed level of 3 average salaries per economy;

(ii) Elimination of exemptions or preferential treatment (calculation basis equal to the minimum wage for CAS, CASS at PFAI / PFI, etc.) without capping the calculation basis will discourage compliance and may lead to reductions in budget revenues.

According to the working group's estimates, the measures proposed above could lead to an increase in revenue in the consolidated budget of around **1.5% of GDP** [21], however, this may be higher due to the current scale of the use of the Fiscal Code to avoid paying income tax and - in particular, CAS and CASS. If this is the case, fiscal space can be created to implement measures to reduce the tax burden on labor, especially on low wages - in which case the reduction could be made by granting the currently regressive deduction for the tax base. on salaries and for CAS, CASS.

[21] The main impact comes from the elimination of preferential treatment for income from independent activities (CAS tax base, CASS equal to the minimum wage), including limiting the applicability of the income tax regime - approximately + 6.3 billion lei, from limiting the use of micro-enterprises for remuneration in order to avoid paying CAS, CASS but also income tax - approximately + 12 billion lei and eliminating the preferential treatment of copyright revenues - + 0.4 billion lei. The elimination of the exemptions from the payment of the salary tax and CASS, corroborated with the capping of the tax base of CAS, CASS at 3 average salaries, also contributes with + 1 billion lei.

2.3. Value Added Tax (VAT)

2.3.1. The current situation

Romania has a standard VAT rate of 19% (reduced from 20% since 2017), but also the following reduced rates:

- 9% for food, including non-alcoholic beverages, for human and animal consumption, medicinal products for human and veterinary use, prostheses and orthopedic products;
- 5% for - inter alia, textbooks, books, access to museums, amusement parks, cinemas, gyms, home delivery (under certain conditions, quite restrictive and with limited impact), but also **hotel accommodation, and restaurant and catering services**, eco food, firewood or heat in the cold season.

It should be noted that Romania applies a reduced rate to all foods, including those whose excessive consumption affects health (sugar, sweets, sweetened beverages, fats), and non-alcoholic foods / beverages may have different VAT rates depending on where they are purchased (9% from stores or 5% from restaurants).

The revenues expected to be collected from VAT have been continuously decreasing from 2016 to 2021, as shown in Table no. 5:

Table no. 4. Planned revenues to be obtained from VAT

	2016		2019		2021	
	Budget Law (thousand lei)	**% in GDP**	**Budget Law (thousand lei)**	**% in GDP**	**Budget Law (thousand lei)**	**% in GDP**
VAT	**52.342.288**	**6,89%**	**69.647.956**	**6,81%**	**69.698.446**	**6,24%**

Source: State budget law, GDP estimated at the drafting of the state budget law

If we analyze the amounts collected from VAT in the same period (Table no. 6), we find that the situation is even more problematic.

Table no. 5. Revenues collected from GDP

	2016		2019		2021	
	Budget execution (thousand lei)	**% in GDP**	**Budget execution (thousand lei)**	**% in GDP**	**Budget execution (thousand lei)**	**% in GDP**
TVA	**51.675.100**	**6,75%**	**65.420.600**	**6,18%**	**79.350.900**	**6,67%**

Source: Budgetary executions published on www.mfinanțe.ro , realized GDP

The yield on VAT collection is at an all-time low among all Member States. According to the annual study of the European Commission on the VAT collection gap (calculated as the difference between the VAT that can be collected theoretically (VTTL) and the VAT actually collected) in the case of Romania it was constantly over 33% of VTTL, the highest in the EU and significantly above the EU average 28. The VAT gap in Romania was also significantly higher than in Bulgaria, which managed to significantly improve its VAT collection, reaching 2019 data are available in the above-mentioned study) at above average performance. The evolution of the VAT collection gap (in absolute values and percentages of VTTL) is presented in Table no. 7.

Table no. 6. VAT Gap evolution between 2015 - 2019

		RO	UE	BG
2015	million euro	6.808	157.672	1.058
	% of VTTL	34,48	13,2	20,67
2016	million euro	6.137	147.146	693
	% of VTTL	35,88	12,3	13,56
2017	million euro	6.077	140.395	649
	% of VTTL	34,3	11,5	12,2
2018	million euro	6.595	140.042	614
	% of VTTL	33,81	11,0	10,8
2019	million euro	7.411	134.436	508
	% of VTTL	34,9	10,3	8,3

*) In the analyzed period (2015-2019), if Romania had collected at the level of the EU average, **the total amount collected in addition would have been 21.95 billion euros (cumulative, 5 years)**.

The huge gap in VAT collection in Romania (three times higher than the EU average) is caused by a combination of factors, but especially by the poor computerization of ANAF. Modern solutions, applied by most EU countries (and not only), such as connecting cash registers to NCFI servers (National Center for Financial Information-operationalized only in 2021) or e-Invoice, have been implemented in Romania only partially and with long delays. The use of AI (Artificial Intelligence) for risk analysis and operationalization of controls is still under discussion.

Another factor which favors VAT fraud derives from the very way in which VAT operates in the common market, the so-called 'transitional regime'[22], regime involving hybrid treatment:

[22] It should be noted that in 2016 the European Commission proposed the transition to a definitive VAT regime, through the so-called "Action Plan on VAT", this regime will involve the collection of VAT on all intra-Community transactions (goods and services) according to state rules destination of consumption. An amending directive was proposed in 2017 and an impact study was carried out, estimating that the introduction of this system would reduce VAT fraud in intra-Community transactions by EUR 41 billion and compliance costs by EUR 938 billion. Although the 2016 proposal envisaged the introduction of the final system in two stages: in 2022 for goods and in 2027 for services, the pandemic has delayed things, and the transitional system is now being implemented.

- installment payments for B2B (Business to Business) and B2C (Business to Consumer) transactions in the same state, except for certain categories of goods with a high risk of evasion (iron old, real estate, energy, computers and mobile phones, grain), for which reverse charge applies;
- reverse charge, for B2B transactions between Member States.

This dual system (transitional VAT regime) allows for massive VAT theft through so-called carousel fraud, a phenomenon known to the Commission, which has implemented several categories of administrative measures, but also the possibility for Member States to apply reverse charge measures, including generalized, in all B2B transactions, under the conditions of the EU Directive 2018/1695. Connecting cash registers to NCIF servers does not help in any way to reduce this type of fraud, and e-Invoice can only facilitate risk analysis and improve the speed of reaction of NAFA, but still does not help prevent carousel fraud.

Reverse taxation, a solution that cannot be generalized without the unanimity of the Member States, has a number of major advantages, especially for countries such as Romania - where the capacity for administration / collection is low:

- completely eliminates carousel fraud (VAT no longer actually flows from buyer to seller, from seller to budget and from budget back to buyer);
- completely eliminates VAT refunds and therefore also the costs associated with tax controls (even if the refund is made with subsequent control), as well as the risk of undue refunds;
- facilitates the collection by significantly reducing the number of taxpayers who actually have VAT to pay;
- significantly reduces the number of litigations pending before the courts (including the CJEU), the vast majority of which are either related to the obligation to collect or the right to deduct VAT in B2B transactions (where VAT should be neutral).

It should be noted that Romania has already introduced reverse charge for a relatively large number of goods and services considered to be of high fiscal risk. However, these measures put additional pressure on producers of these goods (e.g., cereals), as do producers who sell their products / services for export, who have to buy inputs with VAT and subsequently requests its reimbursement from the budget.

Given the significant share of VAT revenues in total tax revenues, a reduction in the VAT gap from about 35% to the EU average of 10% would represent an increase in budget revenues of over **2% of**

GDP. A reduction in the VAT collection gap to 20% (similar to the level recorded by Italy) would result in an increase in budget revenues of more than **1% of GDP**.

2.3.2. Possible solutions

Increasing the VAT revenue to the budget can be ensured mainly through two types of measures:

i) **Limiting the application of reduced quotas**

Revision of the list of goods and services for which a reduced rate of 9% applies, especially for those products for which the stimulation of consumption is not justified from the point of view of the public interest (sugar, fats, etc.). It is also difficult to justify the application of different VAT rates for food, depending on where they are purchased (9% of stores, 5% of restaurants).
On 5 April 2022, the EU Council (ECOFIN) adopted a Directive that will allow Member States much greater flexibility in applying reduced VAT rates. However, this Directive will increase the appetite of Member States to apply even more reduced VAT rates, which could do more harm than good. We believe that - especially in Romania, which has an extraordinarily difficult budget situation - policy makers should use this new facility rationally, applying reduced rates only where it is really economically and socially justified.

ii) **Improving the collection / reduction of the VAT collection gap**

This can be achieved with significant short / medium term results, mainly through the following methods:

a) Computerization of the VAT administration process, by implementing e-Invoice (application for loading B2B invoices in the MF system, managed by NCFI), for all B2B transactions, but also ensuring the correlation of information received from this system with those obtained from cash registers already connected to NCFI. In addition, it should be noted that both the current reporting system implemented for cash registers is already technologically obsolete and RO E-invoice (very recently implemented), an upgrade of these systems to the level at which they have long been implemented in other states. (Issuing invoices and vouchers from the application managed by NCFI, not only reporting their issuance, as at present) can bring additional benefits in increasing the degree of VAT collection;

b) Improving border control to reduce smuggling (especially excisable products), both by using modern scanning methods (at customs) and by using AI to reduce the phenomenon of underestimation of customs values. Improving the functioning of customs and strengthening measures to prevent / combat smuggling would also have a positive effect on the collection of customs duties and excise duties;
c) Generalization of reverse charge under the conditions provided by EU Directive 2018/1695, being hard to believe that Romania does not meet the conditions imposed by this directive [23];
Substantiation of NAFA controls on the result of risk assessments, based on big data analysis techniques in which NAFA collects data on taxpayers and subsequently, the control activity to target those areas of activity where there are high risks of VAT evasion, non-issuance of tax receipts or non-issuance of invoices. This can be done on a model of econometric analysis (highlighting exactly those sectors of activity with problems in this regard). The introduction of SAF-T reporting in Romania starting with 01.01.2022 is a step forward. However, the risk we notice is that a lot of data will be collected and nothing will be done with it. It is essential that this data, once collected, is used in fraud risk analysis. Artificial intelligence (AI) / machine learning (ML) systems can be implemented to analyze transactions / big data and issue VAT fraud risk signals, ANAF having access to banking transactions carried out in Romania.

As mentioned above, a reduction in the VAT gap to the EU average could bring in additional revenue of at least 2% of GDP. A vigorous application of the measures to reduce the VAT gap, but also a reconsideration of the scope of reduced or super-reduced rates, could bring (without an increase in the standard rate of 19%) even 2.5% of Extra GDP to the budget.

It should be noted that this estimate does not include the positive effect that the measures listed above may have on the increase in excise duty revenue, where there are also major collection problems, in particular on alcohol, and less on tobacco (where the share of smuggling market has fallen from about 38% in 2008 to about 10% in recent years) or fuels, where control is significantly better.

[23] On 2 October 2018, the EU Council approved the introduction of the general reverse charge system in countries affected by VAT fraud (https://www.consilium.europa.eu/en/press/press-releases/2018/10/02/vat-fraud-council-agrees-to-allow-generalised-temporary-reversal-of-liability/). The pilot country chosen for implementation was the Czech Republic, and this system will be applied from 1 July 2020 to 30 June 2022, after which an impact assessment will be carried out. (https://wts.com/global/publishing-article/18062020-vat-nl-czech-republic~publishing-article?language=en). However, the Czech Republic has not decided on the application, given the very short time allowed for the application of this system. (https://www.globalvatcompliance.com/globalvatnews/czech-republic-the-general-reverse-charge-is-being-postponed/)

2.4. The tax on buildings

2.4.1. The current situation

The building tax was modified relatively recently, by Law no. 227/2015 (New Fiscal Code) and is established according to two main criteria: (i) the type of use (residential or non-residential) and (ii) the type of owner (natural or legal person), there are practically 4 (four) categories different:

i. for residential buildings owned by individuals, between 0.08% and 0.2% of the tax value calculated according to the Fiscal code. For example, the tax for a 70 sq m apartment located in the center of the capital, the annual tax can vary from 140 lei / year (0.08%) to 350 lei / year (0.2%);
ii. for non-residential buildings (including apartments used for economic activities) owned by natural persons, between 0.2 and 1.3% of the taxable amount. Taxable amount is the acquisition cost / revaluation amount at a maximum of 5 years;
iii. for residential buildings owned by legal entities, between 0.08 and 0.2% of the taxable amount. Taxable amount is the acquisition cost / revaluation amount at a maximum of 5 years;
iv. for non-residential buildings owned by legal entities, between 0.2 and 1.3% of the taxable amount. Taxable amount is the acquisition cost / revaluation amount at a maximum of 5 years.

Although the changes introduced in 2015 (entered into force in 2016) have significantly reduced the huge differences between the building tax owed by individuals compared to that owed by a legal entity (possibly even 100 times higher for the legal entity than for the natural person, for the same building), they were kept because the differentiation was not only made according to the destination (residential / non-residential), but also according to the owner (natural person / legal person), because the existence of the 4 categories allowed local authorities to adopt tax rates equal to or close to the minimum level for individuals (voters), and for legal entities the maximum, often even increased by up to 50%, according to the permission provided for in the New Fiscal Code.

2.4.2. Possible solutions

Differentiating property tax by owner can be easily eliminated by reducing the number of categories from 4 to 2 (residential / non-residential, regardless of the legal form of the owner). Such a measure can completely eliminate the temptation to arbitrate between the two legal forms (natural person / legal person), as there is no reason to establish different taxes. However, the differentiation according to the use of the building (lower tax for those used as housing / residential) must be maintained, for social protection reasons, the alignment of this (residential) tax with the tax due for non-residential buildings can create problems with ability to pay, especially for low-income people.

The tax amount can also be determined using the same method used for residential buildings owned by individuals, thus eliminating the costs of periodic revaluation (for both the taxpayer and the DITL) and creating predictability in terms of local budget revenues. It should also be noted that revaluations for tax purposes are currently made according to a special standard - GEF 500, in line with the above-mentioned provisions, so revaluations are in any case relatively useless from the point of view of the tax base.

In addition, (i) for new construction, the ratio of the tax base to the cost of construction discourages additional investment in modern (expensive) solutions, including solutions to reduce energy consumption or high-quality finishes, which increase the tax base, at least until the first revaluation, and (ii) the incorrect recording of revaluations (although with minimal impact on the tax base) is currently excessively sanctioned (with tax rates of 5-10%), which creates both excessive risks for taxpayers and Issuing a large number of court cases (other administrative costs).

2.5. Vehicle/car tax

2.5.1. The current situation

We consider that the redesign of this tax, so as to eliminate the current discrepancies generated by the taxation exclusively according to the engine capacity (ridiculous taxes for cars with low cylinder capacity vs. excessively high taxes for cars with high cylinder capacity), but also to take into account of age or the pollution norm (with the gradual increase of the tax for old / polluting cars) would not only ensure an improvement of the revenues of the local authorities, but would also serve the public interest to renew the fleet and reduce pollution.

It should be noted that none of the previously implemented public policies (first registration fee, in various formulas, all declared non-compliant with EU law by the CJEU and the amounts collected have to be returned) or currently (Rabla program), all consumers of budgetary resources, did not have the expected impact (renewal of the fleet), its average age increasing from year to year after 2007. This failure is also caused by the fact that Romania has not implemented any measures to discourage retention of ownership of very old and polluting cars, or those abandoned on public space.

2.5.2. Possible solutions

The car tax has a very old regulation, being taken over practically without changes in the New Fiscal Code from the Old Fiscal Code which, in turn, had taken them over from the previous legislation. It is calculated exclusively according to the cylinder capacity of the engine, without taking into account the age, the pollution norm, etc.

The car tax is calculated on groups or fractions of 200 cc, the taxable value for each group being determined according to the engine capacity:

- 8 lei / group, for motor cars with a capacity of up to 1,600 cc;
- 18 lei / group, for motor cars with a capacity between 1,601 and 2000 cc;
- 72 lei / group, for cars with a capacity between 2001 and 2600 cc;
- 144 lei / group, for cars with a capacity between 2601 and 3000 cc;
- 290 lei / group, for cars with a capacity over 3000 cm3.

There are huge differences in tax, which is extremely low for low-capacity cars (most) and extremely high for high-capacity cars. For example, a well-known middle-class model of a large manufacturer has mounted engines of 1,500 cc (8 * 8 = 64 lei / year tax), 2,000 cc (10 * 18 = 180 lei / year, + 281%), 3,000 cc (15 * 144 = 2,160 lei / year, + 3,375%), but also 4,000 cm3 (20 * 290 = 5,800 lei / year, + 9,062%). Basically, the annual tax for the same model is 90 times higher for the version with the largest engine than the one with the smallest engine, a difference that we consider exaggerated.

Please note that the estimated additional revenues of 0.5% and 1.5% of GDP do not include the gains that would result from the change in property and environmental taxes, which will be estimated in Chapter 3.

Chapter 3. Review of property and environmental tax rates

Apart from the deficient collection and the numerous exemptions from the payment of taxes, a third reason for which the budget revenues are lower in Romania than in the comparative states is the low tax rates of some activities and fields. In this chapter we will deal with two such areas, property taxes and environmental taxes. We mention that in this chapter taxes are presented according to the classification in economic structure, similar to the way they were presented in Chapter 1, and not according to the categories of taxes, as classified in the Fiscal Code, presentation that is made in Chapter 2.

It should be noted from the outset that property taxes are a subset of those on capital stock, the same being true for some of the environmental taxes (those classified as transport taxes - excluding fuels). Other environmental taxes (e.g., pollution taxes) are a subset of consumption taxes. As can be seen from Tables 2a-e (Annex C), the total revenues from taxes and duties represent the sum of the revenues from taxes on consumption, labor and capital, respectively, while environmental and property taxes are only subsets of to those before. In other words, any increase in environmental and / or property tax revenues will be found, ceteris paribus, in an increase in consumption / labor / capital tax revenues. Which is desirable, given that, in any of these, Romania receives less than the peer states.

3.1. Analysis of property tax rates

Regarding the recurring taxes on real estate, Romania does not stand out with low revenues. The taxes in question represent on average 0.5% of GDP in the case of Romania, more than in Hungary (0.45% of GDP), Bulgaria (0.3% of GDP) and the Czech Republic (0.2% of GDP).

Poland stands out, collecting around 1.1% of GDP from real estate taxes, mainly from non-residential economic purposes (0.8% of GDP, classified as indirect taxes (other taxes on production) D29). Poland leaves to the local authorities the level of real estate taxation, setting only maximum values of the level of tax per square meter, differentiated according to the destination of areas, at the current year the maximum taxes being 0.89 PLN / m2 useful for residential construction and not less of 25,74 PLN / m2 useful for constructions with economic destination. In conclusion, at this type of tax there does not seem to be room for an increase in tax rates in Romania[24].

[24] https://ec.europa.eu/taxation_customs/tedb/taxDetails.html?id=461/1640991600.

In terms of other property taxes, here Romania stands out with low revenues relative to peers, in this case only 0.1% of GDP given that Bulgaria has 0.5% of GDP, the Czech Republic 0.2% of GDP, Poland 0.6% of GDP, and Hungary 0.7% of GDP. **Taking as a reference these last two states, Romania should propose revenues from this form of taxation of about 0.5% of GDP, i.e., an increase in budget revenues of about 0.4% of GDP compared to the current situation.**

Part of the difference is explained by the existence in some countries of special taxes on the assets of banks / financial institutions (Hungary and Poland, with revenues of about 0.2% of GDP), as well as by the higher number of contributions to guarantee funds / bank resolution (the differences can be explained in the conditions in which the asset base of the Romanian banking system is significantly smaller). But the biggest difference comes from property transfer taxes, from which Romania gets 0.02% of GDP and Bulgaria 0.26% of GDP, the Czech Republic 0.2% of GDP (the tax was temporarily suspended in 2020 in the context of the pandemic), Hungary 0.35% of GDP and Poland 0.13% of GDP:

- Romania is atypical not by the tax rate applied (3%), but by the fact that it deducts from the value of the transaction 450,000 lei (90,000 euros) and does not tax donations between spouses, relatives and relatives up to the third degree;
- Bulgaria also does not tax donations between parents and children (and vice versa) and between spouses, but taxes the total assessed value of the property at 0.4-0.8% for donations between siblings / siblings and sisters (0.7% in Sofia), with 3.3% -6.6% donations between other relatives (5% in Sofia) and with 0.1-3% onerous transfers (3% in Sofia). Tax rates are at the discretion of local authorities within the range of predefined values[25];
- The Czech Republic charges 4% of the value of onerous real estate transactions (some expenses are deductible from the tax base, such as those with an expert assessment);
- Hungary charges 4% of the value of transferred properties in cases where the value of the transaction does not exceed HUF 1 billion, for what exceeds this threshold the difference is taxed at 2%. The tax due may not exceed HUF 200 million per property. In addition, the aggregate reported in the case of Hungary also includes taxes on inheritances and donations, taxed at 18% (9% in the case of residential properties), the only exempt transfers being those between parents and children (or spouses). Furthermore, car transactions are subject to taxation, the amount of tax due depending on engine power (in kW) and age[26];

[25] https://ec.europa.eu/taxation_customs/tedb/taxDetails.html?id=739/1640991600
[26] https://ec.europa.eu/taxation_customs/tedb/taxDetails.html?id=310/1577833200

- Poland taxes all civil law transactions, with a tax rate of 2% for the transfer of real estate and 1% for the transfer of other properties, and the tax base is the market value. Donations / inheritances between very close relatives (spouses, children, parents, stepparents, brothers, sisters) are exempt.

In conclusion, in the case of Romania, the reform should take into account two elements:

- **To allow the deduction from the value of the transaction of the amount of 450,000 lei only in the case of the first home (no deduction is made from the second home purchased);**
- **Exempt from taxation only first-degree relatives (parents, children, spouses), taxing all others.**

3.2. Analysis of environmental tax rates

- **Environmental taxes (energy taxes) -** this includes excise duties on fuels and revenues from emission certificates. Revenues in Romania (around 1.86% of GDP on average in 2018-2020) seem similar to those in the Czech Republic (1.84% of GDP) and Hungary (1.7% of GDP), but lower than in Poland (2.3% of GDP) and Bulgaria (2.5% of GDP). In the case of Bulgaria, emissions from revenues are much higher, but this is most likely due to the energy mix there.

  In conclusion, there does not seem to be room for this type of tax for the increase of tax rates in Romania.
- **Environmental taxes (transport, excluding fuels) -** it seems that countries treat certain elements statistically differently, in this case the Czech Republic reports as tax revenue their toll, while we, Hungarians and Bulgarians do not (most likely in both Romania, Hungary and Bulgaria, vignette receipts are reported as non-tax revenue). Romania collects 0.1% of GDP from this type of tax, Bulgaria 0.3% of GDP, Poland 0.2% of GDP, and Hungary 0.3% of GDP. **Given these, Romania should propose revenues from this form of taxation of about 0.25% of GDP, i.e., an increase in budget revenues of about 0.15% of GDP compared to the current situation.**
- **Environmental taxes (pollution and mineral resources)**

  Romania receives almost nothing, 0% of GDP, unlike Poland, 0.2% of GDP, or Hungary, 0.15% of GDP. Beyond the fact that the environment must be much better protected in Romania, environmental taxes could bring in revenues of **at least 0.15% of GDP**.

These can be considered, among other things:

- **Increasing taxes on plastic containers (bags, bottles, boxes, etc.);**
- **Increasing garbage incineration fees;**
- **Increasing the storage fees for construction materials;**
- **Increasing the storage fees for construction waste, etc.**

All this can be linked to the commitments made under the PNRR on environmental taxes.

If the measures proposed in this chapter were to be fully implemented, the increase in tax revenue would be about 0.7% of GDP. In structure, it would increase consumption taxes by about 0.2% of GDP, to a total of 10.2% of GDP (compared to 11.3% of GDP in the Czech Republic, 12.4% of GDP in Poland, 14 1% of GDP in Bulgaria and 15.7% of GDP in Hungary). At the same time, capital taxes would increase by about 0.5% of GDP to a total of 3.8% of GDP 3% of GDP in Hungary, 4.4% of GDP in the Czech Republic, 5.0% of GDP in Bulgaria and 8.9% of GDP in Poland).

The fact that Romania would still be at the bottom of the ranking shows two things: the importance that other measures (better collection and elimination of tax exemptions and exemptions) have in the process of fiscal convergence with the states reference, respectively the need to obtain increased tax revenues even when the increase seems, at first sight, insignificant. The latter requirement is particularly important given the additional needs for budget spending in the new geopolitical conditions, which emerged after February 24, 2022.

Chapter 4 - The implications of the digital transformation on the Romanian tax system

4.1. The role of digital transformation

Tax administrations have a key role to play in ensuring the revenue of the state, in a fair, balanced way and with a low level of administrative burden. This supports the public perception of fairness, which in turn creates a culture of tax compliance that is essential as long as tax administrations are largely dependent on voluntary compliance by taxpayers. The digital transformation creates new opportunities for tax administrations, given that the data that is collected about taxpayers can facilitate the application of new and improved treatments for tax compliance.

In turn, this new perspective can be used to substantiate future policy decisions that can both broaden the tax base and mitigate the risks of tax non-compliance. Thus, the process of digital transformation is a desideratum, but, especially, through the changes it implies, it represents a means of reforming ANAF in order to improve the collection of tax revenues. **The benefits of digitization will be realized by consistently reducing evasion and increasing compliance, without requiring unpopular interventions to compensate for the inefficiency of the current collection system.**

Through the direct impact on increasing fiscal compliance and significantly reducing fiscal gaps, digitalization contributes to increasing the level of confidence in the fiscal model and supporting predictability, two of the factors favoring foreign investment in Romania.

The impact of digital transformation is found in:

- Increasing compliance, implicitly revenue collection:
    - Higher tax revenues;
    - Higher compliance rate: digital mechanisms ensure uniformity of taxpayer treatment (vertical fairness) which leads over time to a positive attitude towards compliance and thus a decrease in tax evasion;
    - Assist authorities in enforcing tax law and combating tax evasion (including through early warnings).
- Ensuring increased operational efficiency:
    - Lower operating costs;
    - Decreasing the processing time of transactions of any kind (requests, registrations, validations, etc.);

    - Increasing efficiency and effectiveness;
    - Increasing the quality of services;
    - Decreasing to the point of eliminating human errors;
    - Improved controls;
    - Facilitating interoperability.
- Ensuring added value in the economic and fiscal ecosystem:
    - Greater transparency, traceability and trust of taxpayers in the tax system;
    - Equal treatment of taxpayers;
    - Reducing the tax burden;
    - Prevents / fights corruption;
    - Encouraging cooperation with other tax administrations;
    - Switching to a One-stop shop.
- Mitigation of the risks of fiscal non-compliance:
    - **Risk of non-registration or mis-registration.** Managing this risk includes simplifying processes, reducing redundant interaction between the taxpayer and the tax administration, and most importantly, using the data already collected to connect internal tax administration processes and to improve individual risk assessment;
    - **Risk of non-submission of declarations.** There are many good practices for managing this risk, based in particular on improving the (online) communication channel and automating the processes (implicitly developing processes) for sending notifications;
    - **Risk of incorrect completion of declarations.** Digitization has the potential to give a tax administration a better perspective on the work of taxpayers, enabling them to guide them towards compliance. The main good practices are aimed at pre-completing tax returns and introducing a sufficient number of red flags in the process of validating tax returns;
    - **Risk of non-payment.** Digital services lead to an improvement in the rate of timely payment of tax obligations, as well as a reduction in cases of erroneous payment (incorrect calculation or payment in an erroneous budget account), including a reduction in communication costs (transmission of notifications, forced executions).

The behavior of taxpayers not only reflects the decision to comply or non-compliance in terms of reporting, calculation and payment of taxes and duties**, but also the effort to do everything right,** namely keeping records, allocating time for the correct completion of forms, resolving any issues arising from a lack of understanding of the procedures and meeting the reporting requirements and deadlines. Thus, taxpayers assess and balance the administrative tasks of compliance in relation to the risks of non-compliance.

The digital transformation offers the opportunity to address some of the structural limitations of traditional tax administration processes, **by eliminating the sequentially of the steps taken by the taxpayer and integrating taxation at the time of the transaction** that triggers a tax event, as well as its inclusion in taxpayer systems. daily or business, systems called natural systems. By including taxation in taxpayers' natural systems, paying taxes can become an easy and predictable experience.

Such integration will allow **compliance by the implemented concept itself** (compliance by design), which means that **non-compliance becomes predominantly a deliberate action** that requires additional, difficult and burdensome activities for the taxpayer. On the other hand, for those who comply, it leads to possible reductions in compliance costs. Thus, there is a change in the balance of risks assumed by taxpayers, by increasing the risks of non-compliance being identified and reducing the burden of compliance.

Building on an efficient administration framework, the digital transformation gives tax administrations access to large databases. Only by integrating this data and developing analytical solutions can the tax administration increase the efficiency and effectiveness of the process of identifying, assessing risks, determining optimal treatments and monitoring the effects of the application of the set of measures adopted, both individually and sectoral, in terms of fiscal compliance programs.

Table nr. 7. Collection costs

Member State	Collection cost[27]		Share of salary expenditures		Share of ICT expenditures	
	2018	2019	2018	2019	2018	2019
Bulgaria	1,0	1,0	85,3	85,3	3,3	17,4
Czech Republic	1,4	1,3	61,7	62,0	9,7	10,5
Hungary	1,2	1,2	66,4	57,6	**n.a.**	**n.a.**
Poland	1,1	1,1	81,8	84,0	1,1	1,1
Romania	**1,0**	**0,9**	**89,7**	**91,9**	**n.a.**	**n.a.**
Slovakia	1,9	2,1	61,3	59,9	7,0	4,2
Slovenia	0,7	0,7	83,2	82,4	9,3	10,2
Reference group average	1,2	1,2	75,6	74,7	6,1	8,7
OECD average	0,8	0,8	72,9	72,6	10,0	10,3

[27] The indicator reflects, for comparability, the cost of collection in relation to the tax revenue collected (excluding import VAT), stating that there is a variability of collection duties in the case of certain taxes and duties.

Formula	Total operating expenses/(Collected tax revenues – import VAT)*100	Salary expenditures/Total operating expenditures*100	ICT expenditures/Total operating expenditures *100

Source: Tax Administration 2021 - © OCDE 2021 http://dx.doi.org/10.1787/888934271948 Author's calculations

As it results from Table no. 8, in Romania the budgetary expenses related to the collection are mainly dedicated to covering the salary expenses (91.9%), well above the average of the reference group, respectively of the states for which they were collected (59 states). There is also a strong negative correlation between the share of ICT spending and the cost of collection - the higher the cost of ICT, the lower the cost of collection. **Current tax administration systems often impose** burdensome administrative burdens on taxpayers. Companies and citizens have to meet a number of obligations, and as the OECD *Report on Tax Administration 3.0: The Digital Transformation of Tax Administration* shows, this can have a significant impact on entrepreneurship.[28]

Digital transformation is leading to the creation of new digital ecosystems and contributing to the widespread adoption of new technologies, creating new experiences and opportunities for citizens. Tax administrations can play a key role in the development of the wider digital economy, given that they frequently interact with citizens / taxpayers. Also, the assumption by a tax administration of a sustained process of computerization can be a good model and can support, through good practices, the implementation of electronic interaction for other institutions that provide public services.

4.2. The role of NRRP in the digitalization process of the Romanian tax administration

In Romania's PNRR, the integration of digital technologies is widely addressed, in a number of components, in order to modernize the economy and support the response provided by different entities to the challenges of the current economy.

Romania's PNRR includes an essential reform on the development of the government cloud in Component 7 (Digital Transformation), which aims to modernize public administration by establishing the necessary framework for achieving interoperability of IT&C systems of different public institutions, ensuring coherence with the e-IDAS Regulation and in line with the "one-off" principle enshrined in the Digital Single Portal Regulation.

[28] OCDE (2020), Tax Administration 3.0: The Digital Transformation of Tax Administration, OECD, Paris. http://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm
In terms of entrepreneurial activity, companies that have survived the first 3 months are taken into account. The OECD report draws conclusions Braunerhjelm, P., Eklund, J.E. & Thulin, P. *Taxes, the tax administrative burden and the entrepreneurial life cycle.* Small Business Economics 56, 681–694 (2021). https://doi.org/10.1007/s11187-019-00195-0

The plan includes a number of measures that are entirely related to digital administration and public services, with an estimated budget of around € 3,037 million, including:

- Development and implementation of a unified framework for defining the architecture of a government cloud system, as well as cloud development and full cloud migration;
- Technical support for the revision of the fiscal framework, the improvement of the processes of administration of taxes and fees.

Also, Component 8 - Tax reform and pension reform aims (O1) to increase the revenue collected by the tax administration by at least 3 percentage points of GDP (2.5 percent of the tax administration reform and 0.5 percent of the revision of the framework). tax) and the reduction of the VAT gap by at least 5 percentage points, both compared to 2019.

NAFA computerization is operationalized directly through the **Reform** (R1) **of the National Agency for Fiscal Administration (NAFA) through digitization** and investments:

- I2. Improving the processes of managing taxes and duties, including by implementing integrated risk management, which has as its main milestone (Q4 2022) the entry into force of the applicable legal framework that defines the risk criteria for the classification of taxpayers. The legal framework is approved by order of the president of NAFA;
- I3. Ensuring the capacity to respond to current and future information challenges, including in the context of the pandemic, through the digital transformation of the Ministry of Finance / National Agency for Fiscal Administration.

Given that PNRR also covers financing schemes to increase the innovation potential of Romanian companies, by focusing not only on the adoption of existing digital technologies, but also on the development of advanced digital technologies, such as block-chain technology, cloud computing, as well as artificial intelligence, software robots, or chatbots, requires the tax administration to ensure interoperability with these projects at the same level, creating a unitary innovative digital ecosystem.

4.3. Current situation - ongoing projects, SWOT analysis

At NAFA **are implemented or in progress / planning numerous IT projects of which** we list**:**

- AMEF (online connection of cash registers)
- Centralized electronic invoicing system (on two components: B2G and B2B)

- SAF-T (simplification and standardization of control, including remote control). Efficient tax services for administration and citizens (SFERA) - updating the tax administration IT systems and ensuring their interoperability with the IT systems of other institutions
- APIC - Big Data platform for efficient data recovery
- Projects to improve the support infrastructure and build a financial-fiscal cloud and a new data center
- Project to improve the SPV and the capacity to pre-complete the forms
- Customs digitization projects

The weaknesses of these projects are:

- Those already implemented (e.g. AMEF, e-Invoice, SPV, etc.) are not designed on the basis of modern / innovative / sustainable technologies (block-chain, BigData, etc.) that ensure increased benefits for individuals or legal entities and efficiency for NAFA by not repudiating the records (without using the electronic signature, which involves high costs and is difficult to adopt on a large scale), as well as by integrating them with the other systems / applications / technologies used by NAFA. For example, in these cases, blockchain technology would have met these requirements, including ensuring transparency and easy control. In general, projects are defined at the level of digital competence of NAFA and therefore innovative technologies, not currently used, are difficult to find their place in future projects. At the same time, the current system lacks a nomenclature of products and services that economic operators can use standardized in relation to NAFA. Currently, cash registers provide non-standard information to NAFA, information that is not intelligently processed (statistical modeling, predictive analysis, risk profiling, etc.). Thus, the objective of increasing the collection in the current form of implementation is achieved only marginally;
- Not all systems managed by NAFA are centralized, which induces latencies in information processing, errors and a lack of ad-hoc analysis capacity of risk scenarios. In general, IT efficiency is lacking when applications are not integrated;
- NAFA has allocated resources, in particular, for the purpose of data collection, in almost all cases, without having defined processes and workflows for the capitalization and application of unitary tax treatments depending on the validated significance of the data collected. Thus, **there are limited resources and capabilities in the field of data processing, development of methodologies and analysis - data science (data analysis, statistical modeling, data mining, machine learning / predictive analytics, artificial intelligence), a situation that affects** the way of substantiating some decisions and efficient allocation of NAFA resources in

the process of managing taxpayers according to the risk class. At the same time, these deficiencies can have an impact on the adequate substantiation of some fiscal policy decisions at the level of the MoF and, last but not least, they do not allow the exposure to the taxpayer of some inaccuracies that he can remedy.;

- The overall architecture of the information systems is missing, **there is no multi-level architecture that starts from the services to the citizens / companies and from the objective of an increased collection without an operational load of the citizens / companies;**
- **The support infrastructure of information systems is outdated, largely morally worn out and does not allow the modern running in the financial-fiscal cloud architecture of an integrated application platform, based on multi-level architecture.**

The SWOT analysis

Strong points

- Creating an inventory with all digitization initiatives at the level of MF / ANAF, at the level of reform that includes legislative aspects, but also computerization projects
- Defining a financial-fiscal cloud concept in the management of the institution with the role of ensuring interoperability between MF / NAFA applications that trade data protected by fiscal secrecy
- Out of a total of 371.8 million euros budgeted by NRRP for MF / NAFA, 325.6 million euros (or 87.57%) are for digital transformation - source MIPE, NRRP budget (C7, less pension system reform). In addition, 22 million euros were allocated in the NRRP budget for the Ministry of Research, Innovation and Digitalization for the construction / renovation and endowment with specific equipment of the new MF / NAFA data center dedicated to specific applications and managed by MF, separate from the Cloud Governmental
- Launch of projects for connecting cash registers, electronic invoicing and SAF-T
- Availability of a considerable volume of methodologies, guidelines, guides, good practices, examples of successful / failed projects, some of which are included in the bibliographic references below. To these documents, issued in particular by the OECD and the European Commission, are added the exchanges of good practice and the constant participation of NAFA representatives in working groups organized by DG-TAXUD (FISCALIS) and IOTA, as well as Forum on Tax Administration meetings. (OECD)

- Existence of Evaluation and Analysis Reports, which include recommendations, guidelines, methodologies and good practices delivered to NAFA within the Fiscal Administration Modernization Project (RAMP).
- By virtue of administrative cooperation, ANAF has access to the experience of other tax administrations and lessons learned from them in the implementation of digitization projects, including directly, through online meetings or working visits.
- According to public data, the investments made by NAFA in digitalization are not at a level where, in the event that the whole system would change, the losses would be intolerable (details above, regarding the share of ICT expenditures). On the other hand, the costs already borne by taxpayers in some projects (e.g., electronic cash registers) are considerable.
- There is the prospect of financing computerization within the National Recovery and Resilience Plan (NRRP).

Weaknesses

- Lack of a data center with modern infrastructure dedicated to specific financial-fiscal operations.
- Exclusion of the General Directorate of Customs (GDC), responsible for collecting customs duties, excise duties and VAT on imports, from 2022. Fragmentation of NAFA by excluding GDC makes impossible the top-down approach, vital for a successful computerization at NAFA, which is, however, possible at the Government level. We recommend keeping the IT structure related to GDC within NCFI in order to use the existing infrastructure. In this way, NCFI can concentrate technical and human resources capable of serving any of the entities in the financial-fiscal area (NAFA, GDC, MF, BNI, Treasury, NCGFSME, etc.).
- The deadline for connecting the cash registers to the NAFA server expired on November 30, 2021. The vast majority of them are connected, with a few exceptions (by extending the legal term for certain categories, by non-compliance, technical malfunctions or lack of internet). Although these cash registers provide a lot of information, a software architecture has not yet been created to analyze this information and provide data to combat tax evasion. Such a platform would significantly enhance the results of this investment.
- Although the implementation of SAF-T is on an extended scheme, it does not lead to the elimination of existing forms, thus increasing the burden of financial-fiscal reporting instead of simplifying it. There are many situations in which the same data is transmitted by taxpayers several times to NAFA. For example, those who optionally use RO e-invoice and issue invoices from the NAFA server, send the same data to SAF-T and submit the same VAT returns as a taxpayer who does not use RO e-invoice and does not file D 406 (SAF- T).

- Despite the imposition by NAFA on taxpayers to enroll in the VPS as of March 1, 2022 to communicate only electronically, NAFA did not digitize all of its statements. Recently, as a result of some articles in the press, NAFA came with the specification that the non-digitized forms are scanned and sent by email or uploaded, in order to be taken "by hand", in VPS.
- The complexity of tax legislation discourages bona fide taxpayers, and the complexity of the forms, the opaque and often counterintuitive way of completing has a negative impact on compliance.
- The services and solutions offered by NAFA are mainly designed to consume as little energy as possible for civil servants and not to facilitate tax compliance for the taxpayer.
- Lack of digital transformation, lack of systems for capitalizing on collected data and predictive analytics lead to the perpetuation of the paradigm of forcing taxpayers to comply, non-uniform application of tax treatment and inefficient allocation of resources, without a risk-based approach, instead of stimulating compliance and to support, through modern taxpayer support services, the development of a fiscal culture. A risk-based approach leads to an efficient allocation of resources and prevents situations where, in order to validate the control decision, the inspection body exerts undue pressure (e.g., the practice of suspending controls that do not identify problems within the allotted time horizon). We recommend defining and publishing relevant indicators on a monthly basis to ensure that these practices are monitored and avoided.
- MF and NAFA do not react when they notice on the market generalized behaviors of taxpayers that they consider non-compliant with the legislation. Years after the generalization of the phenomenon, thematic controls begin, with the effect of removing taxpayers from the market in view of the sanctions imposed (additional debts, interest and penalties for delay). As examples: the situation of per diems, gift vouchers, VAT properties, tips and more. In countries with developed tax governance, once such behavior is reported, the tax authority engages in a campaign to publicize the identified situation and motivate taxpayers to comply.
- Multitude of statements and forms, often unnecessary. The process of giving up statements often involves merging them into a larger one. As examples – the declaration on turnover obtained in the previous year (which can be summed up from the declarations submitted by the taxpayer in the previous year) or the single declaration used by individuals, born from the merging of 4-5 other different declarations.
- Lack of pre-filled forms. To the extent that NAFA already has all the information about a certain taxpayer, that information should no longer be filled in from scratch by the taxpayer, but should be pre-filled in the forms.

- There are no up-to-date databases or sufficient illustrative materials prepared by NAFA to support taxpayers.
- There is no prompt reaction from the tax and regulatory authority in the event of new sources of revenue. As an example – the explicit specifications in the Fiscal Code on the taxation of virtual currency earnings were implemented only in 2019, they are schematic and incomplete so far.
- The quality of tax inspections is poor. The percentages in which NAFA loses in court are about 40% (NAFA report sem. I, 2021), which shows deficiencies in the preparation of tax authorities and the practice of forcing the interpretation of the law with the consequence of triggering the bankruptcy of companies in such disputes tax. At the same time, the insufficient/erroneous substantiation of some control acts can favor a dishonest taxpayer, by favorably resolving, in court, the appeal filled by him.
- There is no electronic platform to allow the centralized sale of confiscated goods. The lack of this platform can lead to opacity and can affect the capitalization of goods in market conditions.
- Personal tax records are outdated and continuously report errors. In addition to demotivating the taxpayer in good faith, it most likely does not optimize the degree of tax collection. This complicates the interoperability of the systems because with an automatic reporting of information to another authority, the taxpayer may find the rejection of a file based on erroneous or outdated data (late reconciliation, etc.).
- The call center does not address the problems of ordinary citizens and is not doubled by chatbot technologies that solve efficiently and provide guidance for simple questions. More:
    - there are no performance indicators/KPIs related to the interaction to be published in real time on the site: average waiting time, identification of peak periods and working procedure during peak periods by number of operators, average call duration, number of missed calls, etc.;
    - system for monitoring the evolution of applications (monitoring each request with the key points of the associated business process and the assigned manager, with contact details and warning for exceeding the deadline);
    - the answers to the questions asked by the taxpayers are written in a technical language, difficult to interpret;
    - NAFA and MF do not currently have a system to collect the problems reported by taxpayers (from the lack of tax forms that make it impossible to apply the legal provisions, to ambiguities in legislation or legislative vacuum) which leads to lack of

reaction and exposes taxpayers, even those in good faith, to the fiscal risk of different interpretation of the fiscal control bodies.

Opportunities for the digitalization process of the Romanian tax administration

The Authority for the Digitalization of Romania (ADR) launched in December 2020 a comprehensive project to create a national strategic framework for the adoption of innovative technologies in public administration 2021-2027. Areas covered include **artificial intelligence, blockchain technology, cloud technology for open science and high-performance computing**.

Relevant initiatives launched by ADR in the period 2020-2021 include:

- improving the national electronic online payment system (ghiseul.ro);
- launching the implementation of the Centralized Software Platform for Digital Identification (CSPDI) project;
- performing an analysis and finalizing the document on the barriers to the digitalization of the public and private environment in Romania;
- finishing the public policy on e-government, which is the action plan for the next 10 years, establishing a program of measures for the digitization of public administration;
- launching an inventory of existing digital public services provided by central public administration authorities. Once completed, the Digital Public Services Register will indicate areas/sectors that are not sufficiently computerized and will make it possible to identify new directions of action that meet the real needs of public institutions.

Opportunities:

- Taking over the consultancy offered within the RAMP project and updating it at the level of 2022, in order to effectively define the concept of financial-fiscal cloud.
- Legislation and effort to simplify the PoS implementation procedure at all points with connected cash registers. Currently, there are approximately 250,000 PoS in VISA/MC statistics for approximately 400,000 traders. The difference compared to the 650,000 cash registers is the impossibility to carry out banking transactions for 62% of the points of sale. In order to increase the number of PoS, the cash-back option must be re-activated as an obligation, as well as lowering the turnover ceiling of the trader from 50,000 euros to 10,000 euros, the option initially proposed.

- The attention paid in NRRP for the integration of decentralized systems, such as the Treasury, SIACF (Centralized Debt Management System) - SFERA, etc.
- Taking over the solutions successfully implemented by other countries to increase the degree of collection and transparency of transactions.

Threats in the process of digital transformation of the Romanian tax administration

The main threat comes from the low level of digital transformation in the field of public services in Romania as a whole, which directly affects the performance of the tax administration.

Regarding digital public services**, according to the Digital Economy and Society Index (DESI)[29], at the level of the EU member states for the year 2021, Romania ranks on the last place** in terms of digital public services for citizens and businesses, users of e-government services and pre-filled forms.

The Authority for the Digitalization of Romania carried out an analysis of the barriers to the digitization of the public and private environment in Romania. With regard to the public sector, the report states that the following **barriers** should be addressed: **the lack of an efficient and effective ITC architecture**; **lack of ITC systems for central public institutions**; low number of e-government specialists; the absence of a coordinated and efficient legislative and procedural framework[30].

Romania ranks last in terms of this dimension among the member states, as all indicators are well below the EU average. Only 16% of Romanian online users actively interact with e-government services, compared to the EU average of 64%. In terms of the indicator for pre-filled forms, Romania's score of 6 is well below the EU average of 63. In terms of digital public services for citizens and businesses, respectively, Romania has a score of 44 (EU average: 75) and 49 respectively (EU average: 84). With a score of 69%, the country has results below the EU average of 78% in terms of open data.

The computerization process was understood differently by the institutional management, without a vision and a unitary architecture, without an orchestration of the digital transformation, the level of maturation being reduced.

[29] https://digital-agenda-data.eu/. The composite DESI index has 4 major axes: connectivity, human capital, digital public services, digital technology integration, each with several sub-components. At the DESI level, Romania is also on the last place.
[30] Barriers to the Digitization of the Public and Private Environment in Romania, ADR, April 2021, p. 12.

4.4. Recommendations and examples of good practices

Examples of good practices

Benefits of digitization can be seen in Austria, Estonia, Finland, Sweden, etc., where digitization projects for tax systems with effective results are effectively implemented, such as:

- the use of electronic signatures and forms in relation to the state reduced the costs of tax administration by 2% of GDP each year in Estonia after 2016. The integrated tax information system allows tax forms to be pre-filled and submitted electronically even in just one minute.
- reducing by 15% the VAT evasion in Hungary and, in Slovakia, through the implementation of EFCR.
- achieving a 5-7% VAT collection gap in Finland by digitizing the tax system.

The example of Austria

Among the many possible examples that can be studied and taken as models of good practice, we mention Austria, which in 1997 separated the computer center of the Ministry of Finance and created a state-owned limited liability company through the Austrian Ministry of Finance - **Federal Computing Center** or **Bundesrechenzentrum** (BRZ - https://www.brz.gv.at/en/). This company manages all the databases of the Austrian state, but also of the federal or local public institutions, offering integrated services to all of them.

One of these services is FinanzOnline, functional since 2003, which provides an interface between the Austrian Ministry of Finance and taxpayers, but also with tax consultants, lawyers, notaries, municipalities. For example, FinanzOnline offers:

- Submission of statements and other requests, including refund requests;
- Declarations are processed automatically (only the correctly prepared ones can be submitted);
- Only the statements identified with risk by the automatic risk analysis module are sent for verification to the tax inspectors;
- Automatic (anonymized) calculation of tax obligations;
- Changes of personal data online;
- Online access to the personal tax file;
- Transmission of taxation decisions;
- Optional packages for tax and accounting consultants;
- The service is 24/7, without special software.

FinanzOnline has allowed 4,000 employees of the Austrian Ministry of Finance who provided an interface with the taxpayer to be relocated to carry out other activities.

Similar FinanzOnline services are available to both ministries and local authorities, including at the municipal level.

Examples of the use of blockchain technology

In Finland, tax authorities have begun working with banks on a blockchain system to track taxes on real estate transactions. Finland has also carried out a pilot project to assess the effectiveness of a blockchain-based VAT system.

In Sweden, tax authorities are testing blockchain to digitize the use of receipts, to implement electronic solutions on non-resident income tax and customs duties.

Estonia has moved a number of government services to the blockchain, including banking, health and business registries.

Recommendations

1. **Develop a digital transformation policy for tax administration that should take into account key issues that support:**

- **strategy:** Development of the Strategy of the National Agency for Fiscal Administration 2021-2024[31], as well as of the Digital Strategy 2021-2025[32], in accordance with good practices and OECD recommendations.
- **organizational structure and effective organization**
- **management and possible committees set up** *e.g., Committees for Control Activities, Risk Management, Internal Audit.*
- **culture on risks and conduct** *e.g., Development: Strategies for managing the risks of fiscal non-compliance, Procedures for addressing the conflict of interests, in implementing the provisions of the Administrative Code.*
- **internal control** *e.g., procedures regarding the management of the risks of non-compliance, the evaluation of the efficiency/effectiveness of the application of the fiscal treatments, the evaluation of the compliance of the fiscal administration with the regulations from the primary*

[31] https://static.anaf.ro/static/33/Anaf/20210316192634_strategia_anaf_2021-2024.pdf
[32] https://static.anaf.ro/static/33/Anaf/20210316192555_prezentare_strategie_digitala.pdf

legislation. In the primary legislation there are frequently provisions regarding the implementation of a process by order of the president of NAFA. By way of example, by Law no. 30/10.01.2019 for the approval of the Government Emergency Ordinance no. 25/2018 on amending and supplementing some normative acts, as well as for the approval of some fiscal-budgetary measures, art.7 of Law no.207/2015 was amended, in the sense of administering fiscal receivables according to the class/subclass of fiscal risk in which taxpayers are. At the same time, the Orders of the President of NAFA regarding the elaboration of the procedures regarding the risk classes and the fiscal treatments were to be elaborated within 90 days from the date of entry into force. The term for the two orders is currently exceeded by about 3 years.

- **information systems and business continuity**
- **transparency requirements**

2. Implementation of **good governance principles in the development of the internal administration framework of NAFA**, in order to create the premises for the implementation of a digital transformation process

3. **Understanding existing ICT capabilities and needs**, based on a documented analysis process

4. Implementing the **framework for managing the risks of non-compliance with the tax** and directing the administration's efforts towards:

- **extensive** analysis and capitalization of data already collected or collected in ongoing projects;
- reducing the administrative burden for the taxpayer.

5. **Establish a tiered IT architecture**, starting from the catalog of services – the application architecture to support them, based on a data architecture, an infrastructure architecture and a communications architecture, all integrated and in internal and external interoperability, based on a strategic plan.

6. **Establish unitary IT governance, including data management**, so that public digital services to citizens and to business environment cover all their life events. Application of the following principles:

- **The "information-oriented" approach** - the transition from document management to data and content management that can be identified, distributed, secured, combined, in a much more useful way to the beneficiary of the information.

- **The "distributed platform" approach** - supporting joint work, inside and outside tax institutions and administrations, to reduce costs, support joint projects, consistently apply standards, ensure consistency in how information is created and delivered.
- **The "customer-oriented" approach** - influences how data is created, managed, and presented on websites, applications, directly provided data, or other delivery models, allowing the taxpayer to adapt, distribute, and use the information.
- **The "security and confidentiality" approach** - ensuring that innovation takes place in a secure and confidential manner in the delivery and use of digital services.
- **The "value of data, information and people" approach** - the wealth of information held by NAFA is a "national asset", with significant potential value for the public, entrepreneurs and government programs.

7. **It is necessary to quickly implement the interoperability framework, according to the legislation and good practices, as well as the specific architectural models** that will be the basis for the development of NAFA projects, so as to facilitate **the transition to cloud, block-chain technologies. chatbot, robotic process automation and artificial intelligence/machine learning**.

8. **Segmentation of strategic, operational, infrastructure, cybersecurity levels** (clarification of data and information flows taking into account the phases of computerization projects, starting from conception - analysis, design, approval, financing, procurement, contracting, implementation, operation and administration, up to the provision of support and maintenance and decommissioning, refactoring or extension).

Necessary measures for the implementation of the recommendations

- **Implementing a top-down approach to digital transformation, updating[33] the catalog of services to citizens/companies, based on a multi-level architecture**, which ensures, inter alia, interoperability, data governance and the application of the concept of having a single version of the truth (the "once-only" principle) throughout the NAFA data structure.
- **Ensuring adequate human resources and real-time monitoring (adoption of governance principles and Project Management methodologies) for the successful implementation of all projects funded under NRRP, with special attention to projects for data analysis collected by NAFA**. Interviews[34] of OECD with tax officials and organizations involved in the

[33] According to the data available on the NAFA website, the last update date is 24.05.2019.

[34] OECD (2021), Supporting the Digitalization of Developing Country Tax Administrations, Forum on Tax Administration, OECD, Paris. www.oecd.org/tax/forum-on-tax-administration/publications-and-products/supporting-the-digitalization-of-developing-country-taxadministrations.html

efficiency of the tax administrations constantly identifies the *lack of leadership* as the most common cause of the difficulties of project implementation.

- Consolidation and extension of data analysis capabilities, given the milestone (Q4 2022) in the NRRP on defining risk criteria for taxpayer classification, as well as the target to increase revenue collected by the tax administration by at least 3 percentage points of GDP, from which 2.5 percent of the tax administration reform;
- **Priority implementation of technologies and projects with fast results, such as pre-filled forms, software robots and statistical modeling to increase the degree of compliance and trust of taxpayers in the digital transformation process of NAFA.**
- **Analysis of the possibility of implementing innovative technologies in NAFA projects, for example block-chain technology**, based on the strategies launched at national level by the Romanian Digitalization Authority, mentioned above, following the European examples also presented.

Chapter 5 - Final conclusions and recommendations

5.1 General and principled findings

At the beginning of 2022, Romania had to make a fiscal adjustment (a reduction of the budget deficit) of about 4 percent of GDP - from about 7.2% of GDP ESA deficit in 2021 to about 3% of GDP in 2024. In addition to the effects of the war in Ukraine, which involves, among other things, increased budget spending on defense, ensuring energy and food security, protecting vulnerable households from rising energy prices, receiving and hosting Ukrainian refugees, and so on.

Romania has to achieve, in the medium and long term, a greater fiscal budgetary adjustment, in order to ensure fiscal-budgetary sustainability and to face the new challenges. It is clear that a large share of this large-scale adjustment must come from increased fiscal and budgetary revenues, with budget expenditures on an upward trend.

With 26% of GDP tax revenues (including social security contributions) collected in recent years, Romania lags far behind countries with a similar level of development, Poland (about 36% of GDP) or Hungary (about 36.3% of GDP) and even after a less developed state, Bulgaria (30.6% of GDP). The causes of this backwardness are well known: a low degree of taxes and fees collection; a multitude of exceptions and exemptions that diminish the tax base; certain tax rates are very low compared to those in Central and Eastern Europe.

The macroeconomic/budgetary correction that Romania needs is also visible in terms of twin deficits - the existence of growing external (current account) deficits in recent years. Thus, the current account deficit was around 5% in 2019 and 2020 and increased to approx. 7% in 2021; the trade deficit has been growing steadily, illustrating a problem of competitiveness beyond excess demand.

Budgetary correction is also needed, because monetary policy alone cannot maintain the stability of the leu, especially since external deficits have predominantly fiscal causes and causes related to the nature (lack) of structural reforms. The more unclear and unconvincing the correction of the budget imbalance, the more difficult the NBR's task will be to ensure macroeconomic stability and the protection of the national currency.

It is not the excessive deficit procedure that is the first reason why it is necessary to correct the budget imbalance, but the situation of the economy itself, which makes the trajectory of public debt unsustainable if there is no correction, even gradual, given the magnitude of adverse shocks.

In this context, it is clear that the budget adjustment can only be gradual, but it must take place, be translated into credible measures, have a strong political backing and support from broad economic and social circles - including the business environment. In this context, it is absolutely necessary that decision-makers in the political and administrative environment no longer promote tax cuts, as well as the increase in permanent expenditure at the expense of temporary income.

It should be noted that one of the advantages of the single tax rate (lost over time through numerous exemptions and derogations) is the similar tax treatment applied to taxpayers. That is why tax reform should start by correcting the many privileges and inequities in taxation so that taxation to be uniform and proportionate, regardless of the nature of the business and the way it is organized. The undesirable alternative would be ad hoc increases in taxes and fees, imposed by the constraints of financing twin deficits, which would leave unfair treatment of taxpayers unaddressed.

The authors of this analysis do not dispute the need for sectoral policies and specific state interventions in the economy. Moreover, the international context makes such policies inevitable in areas such as the energy industry, the agro-industrial sector, the defense sector, in addition to the challenges posed by climate change, pandemic, Ukrainian refugees, etc.

State interventions in the economy should follow a number of principles, which have been ignored in recent years:

- public spending must be set on a very strict basis, so as to avoid wasting public money. A transparent and efficient system of spending public money should be implemented at the same time as measures to increase tax revenues;
- the single tax rate is based on the principle of proportional taxation of labor. In fact, through many exemptions from this type of taxation, some taxpayers end up being taxed regressively, while other taxpayers are taxed proportionally, which erodes the spirit of fairness and solidarity in society;
- companies should not benefit from multiple tax privileges;
- the aid policies of some sectors should be aimed at increasing their investment and productive capacity and not just at maintaining a certain level of purchasing power or consumption;
- permanent expenditure cannot be financed with temporary income, be it grants from the European Commission.

Offers to reduce tax rates must disappear from public discourse, at a time when the consolidated budget is under extraordinary pressure. Punctual and temporary interventions are not excluded, they may be necessary in very difficult conditions, but their permanence and generalization must be avoided.

The rethinking of the tax system must take into account key issues regarding transparency, fairness, the correct distribution of the burden of adjustments to various adverse shocks, solidarity, encouraging labor market participation, encouraging compliance with payment and fulfillment of obligations, discouraging tax evasion and tax arbitrage and so on. It is not fair for entire fields of activity or social classes to be treated preferentially and for aggressive tax optimization to be allowed through various loopholes left in the tax legislation.

The first front of urgent action concerns the significant reduction of tax evasion and the elimination of exceptions and exemptions, implicitly a major improvement in the collection of taxes and duties in the coming years. Such action takes into account the current context, marked by the slowdown in economic growth, the energy crisis, the war in Ukraine, etc., which does not allow tax increases to be increased for taxpayers who do not benefit from exemptions. Depending on the circumstances, additional measures to balance the public budget and an increase in taxes, such as environmental or property taxes, may be considered.

The alternative to not significantly increase tax revenues to reduce the budget deficit is to drastically reduce spending (by a few percent of GDP), which is an equation that the members of the Group consider impossible to solve. This does not mean that the efficiency of public spending is not necessary/possible, but we believe that efficiency could mean a better allocation of these expenditures (which would increase the quality of public services, which many taxpayers claim to be insufficient) and not necessarily the reduction of them.

The avalanche of new challenges requires consideration of the following: (i) most of the budget consolidation will have to be done on the revenue side; (ii) any new legislative initiative for fiscal relaxation will make the adjustment process much more difficult; (iii) the phasing out of budget revenue growth will need to be updated, in the sense of legislation during 2022 and implementation starting in January 2023.

A considerable increase in tax revenues cannot be achieved in the short term, it takes several years. And it is to be admitted that the year 2022 is very complicated by the overlapping of crises and the prospect of a strong slowdown in economic growth, which requires attention in the process of rethinking the fiscal regime. But budget consolidation is absolutely necessary.

5.2 Current situation on the major categories of taxes and recommendations

5.2.1. The current situation

Regarding the main taxes and contributions, according to the categories defined by the Fiscal Code, we can appreciate the following:

- on income tax, Romania collects about a percentage of GDP less than Bulgaria and about 3 percent of GDP less than Poland and Hungary, primarily due to the low tax rate of 10 percent;

- the profit tax, although the level of income seems in line with that of the comparison state, is affected by the very permissive manner in which micro-enterprises are defined and taxed;

- at VAT, Romania collects about 3 percent of GDP less than peer states. This is due to both lower statutory rates and tax evasion, as well as many exceptions and exemptions legislated in recent years;

- overall, CAS revenues of 11.1 percent of GDP appear to be in line with those in Poland and Hungary and slightly above those in Bulgaria, but here too there are exceptions and exemptions for certain occupational groups.

Regarding the economic structure of taxes and fees, comments can be made:

- consumption is under-taxed in Romania compared to all peer states. The default consumption tax rate is 15% for Romania[35], compared to 19% for Poland, 26% for Hungary or 21% for Bulgaria;

- labor is also under-taxed in Romania[36], contrary to widespread opposition. The implicit rate of labor taxation, 31.1%, is lower than in Poland (33.9%) or Hungary (38.2%), even if higher than in Bulgaria (25.4%);

- capital is also under-taxed in Romania, especially with regard to taxes on income from independent activities and capital stock tax;

- among the property taxes, those related to the transfer of real estate are distinguished by a low collection rate.

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[35] And due to tax exemptions.

[36] Idem.

5.2.2. Recommendations on the main categories of taxes and contributions in the Fiscal Code

The proposed solutions for the revision of the Fiscal Code are mainly based on restoring the tax base, both for profit tax and for income tax and compulsory contributions (CAS, CASS) and are based on the principle of placing the tax burden exclusively on the size of income. and not of its kind, without privileges or discrimination and include the following measures:

Regarding the taxation of legal persons

(i) Elimination of the specific tax owed by large HoReCa companies and return to the 16% corporate tax;

(ii) Limiting the scope of the micro-enterprise income tax by reducing the ceiling from EUR 1 million to EUR 100,000, in conjunction with limiting the use of this scheme for consultancy and management activities, activities associated with the liberal professions or intermediation activities, and limiting the number of companies applying the simplified regime of micro-enterprises that can be set up by one person.

In terms of income tax and social security contributions

(i) Elimination of all exemptions from payroll tax (IT, construction and construction services, production of construction equipment and materials, seasonal workers in HoReCa, research/development);

(ii) Elimination of exemptions from CASS payment (construction and construction services, production of construction equipment and materials);

(iii) Reducing from EUR 100,000 to EUR 20,000 the limit for which persons earning income from certain self-employed activities may use the calculation of income taxable income;

(iv) Clear regulation of the taxation of earnings from cryptocurrency and NFT trading, using the currently existing solution for taxation of gains from the trading of securities on regulated markets (10% income tax);

(v) Limiting the non-taxable amount of 450,000 lei to the income obtained from the sale of real estate from personal property to a maximum of one sale and limiting the exemptions to donations between relatives or relatives of degree 1; alternatively, the replacement of the income tax with the 10% income tax;

(vi) Elimination of the reduced rate of 5% for the taxation of dividends and its replacement by the standard rate of 10%;

(vii) Introducing measures to make it more efficient to impose unjustifiable amounts and to discourage the accumulation of such amounts in the future;

(viii) Reform of the CAS and CASS application as follows:

- Application of CAS and CASS on cumulated revenues and not separately on revenue sources;
- Capping the tax base of CAS and CASS to a maximum of 3 average salaries per economy per month (36 average salaries per economy per year), the tax base being equal to the amount of income obtained by the taxpayer, from any source. If all exemptions are not eliminated, the capping of the CAS tax base, CASS will have to be done at a level higher than 3 average monthly salaries/36 average annual salaries, so that the budgetary impact is not a negative one.

Regarding VAT

i) The revision of the scope of the reduced quota of 9% for foods whose excessive consumption is harmful to health, respectively the application of the standard quota of 19% for them;

ii) Waiver of the reduced rate of 5% applicable in HoReCa, respectively application of the reduced rate of 9% valid for food and non-alcoholic beverages;

iii) Implementation of reverse charge, under the conditions established by EU Directive 2018/1695;

iv) Rapid implementation of RO e-Invoice for all issued invoices;

v) Interoperability of EFCR and RO e-Invoice systems and rapid implementation of modern technologies (AI, Blockchain, BigData Analysis) for risk analysis in order to direct fiscal control especially to areas with high fiscal risk.

In terms of local taxes

i) Elimination of tax differences depending on the legal status of the owner (legal entity or natural person) when calculating the building tax;

ii) Replacement of the current way of calculating the tax on motor vehicles (exclusively depending on the cylinder capacity of the engine) with one that also takes into account the age/pollution norm.

5.2.3. Property and environmental tax recommendations

Property taxes and environmental taxes are subsets of taxes on consumption, capital, and/or taxes on labor.

If Romania collects real estate taxes similarly to peer states, the possibilities of arbitration between the tax rates for individuals and legal entities for the same type of building should be eliminated. At the same time, the time frame for which local councils can set tax rates should be shortened, especially for individuals, given that local authorities often decide to apply the minimum rate of 0.08%, even when they cannot cover their own running costs.

The design of recurring taxes on means of transport (cars) should be redesigned, eliminating the current discrepancies generated by taxation solely on the basis of engine capacity and paying more attention to the age and pollution rules of the vehicle. The current tax regulations do not serve the purpose of renewing the fleet. The estimated gain is about 0.15 percent of GDP.

5.3 Regarding the digitalization of the tax collection system

- Digital transformation (DT) has a multiple role because it can be seen as **a desideratum**, but also as **a tool**, a means to contribute to the fulfillment of **two main objectives**: the reform of NAFA, the improvement of tax revenue collection.
- DT develops a **culture of tax compliance** to create new habits in voluntary compliance of taxpayers, placing the taxpayer at the center, especially for the young technology-consuming generations, and provides a positive experience for them, including through a one-stop shop, reducing effort/administrative tasks for the fulfillment of obligations.
- **DT substantiates future policy decisions** that can both broaden the tax base and mitigate the risks of tax non-compliance.
- **DT ensures increased compliance**, implicitly higher tax revenues, ensures **increased operational efficiency**, by reducing collection costs, increasing efficiency and effectiveness, improved controls, facilitating interoperability, ensures **added value** within the economic and fiscal ecosystem through transparency, traceability and greater trust of taxpayers in the tax system, reduction of the tax burden, prevent/fight corruption.
- **DT mitigates the risks of tax non-compliance**, respectively the risk of non-registration or abusive registration, the risk of non-submission of declarations, the risk of incorrect completion of

declarations, the risk of non-payment and the immediate visibility of these errors to be easily corrected or investigated.

- **DT policy needs to be developed** for effective tax administration that take into account strategy, organizational structure and effective organization, governance, risk and conduct culture, internal control, information systems, transparency requirements.
- **It is necessary to implement a top-down approach to digital transformation, from defining the catalog of services to citizens/companies, based on a multi-level architecture** to ensure interoperability, unitary IT and data governance, by applying the "information", "open and distributed platform", "customer orientation" and "security and privacy".
- **It is proposed to implement as soon as possible a BigData/Data Analytics/Business Intelligence analysis system**, a data management for the application of the concept of "one version of the truth" ("once-only" principle) for the application of optimal treatments and monitoring the effects.
- **It is necessary to quickly implement the interoperability framework, as soon as the legislation is voted, as well as the specific architectural models** that will underlie the development of NAFA projects, so as to facilitate **the transition to cloud, block-chain, chatbot technologies, robotic process automation and artificial intelligence**. Analysis of the possibility of completing or extending EFCR and electronic invoice projects using block-chain technology. The use of these technologies will allow the integration of the knowledge necessary for their efficient operation at the institution level through projects such as the implementation of the financial-fiscal cloud concept with integrated interoperability and security, validation of blockchain transactions, running risk scenarios with artificial intelligence, the use of software robots to pre-complete applications, etc.
- **The principles of compliance by design, secure by design, cloud ready, one-stop-shop, once-only will be applied** in the integration of current flows through transformation and integration which will determine that non-compliance becomes a deliberate and visible action.
- **Romania's NRRP** aimed at modernizing the public administration (371.8 million euros budgeted for MF/NAFA, 87.57% are for digitization, 22 million euros for the new data center). Reforms and investments include the development of a unitary framework and technical support for the revision of the fiscal framework, the improvement of tax and fee management processes.
- **The national strategic framework for the adoption of innovative technologies** in public administration 2021-2027, proposed by the Romanian Digitalization Authority, includes the fields of artificial intelligence, block-chain technology, cloud technology and high-performance

computing, and proposes e-government, including the **Register of digital public services, also applicable in the field of taxation**.

- **According to the Digital Economy and Society Index (DESI) at the level of EU Member States for 2021, Romania ranks last** in terms of digital public services for citizens and businesses, users of e-government services and pre-filled forms, requiring urgent measures in this regard.
- NAFA projects **implemented or in progress, respectively** EFCR (online connection of cash registers), e-Invoice, SAF-T (simplification and standardization of control) should be **expedited and redesigned processes to include modern/innovative technologies** (block-chain, BigData, AI, software robots, etc.), **to ensure the ability to manage, analyze and process data efficiently**.
- **The benefits of digitization will be realized by consistently reducing evasion and increasing compliance, without requiring unpopular interventions to compensate for the inefficiency of the current collection system.**
- **Examples of direct benefits** can be seen in Austria, Estonia, Finland, Sweden, etc., where the digitization projects of tax systems with significant results are effectively implemented, such as: savings of 2% of GDP with tax administration costs in Estonia every year after 2016, 15% reduction in VAT evasion in Hungary, Slovakia by implementation of EFCR, achieving a VAT collection deficit of 5-7% in Finland by digitizing the tax system, etc.

Final conclusion: if the recommendations of this study were implemented, then fiscal revenues (including insurance contributions) could increase by about 3.7 to 4.7 percent of GDP over the time taken to correct the budget imbalance. Of this increase, about half would come from the elimination of discriminatory exemptions and treatment (especially profit tax, income tax and insurance contributions), about a third - from improved collection (especially VAT), including through the digitization of NAFA, and about one-sixth - from rising tax rates (especially on environmental and property taxes).

Such an increase would allow the budgetary correction necessary to get out of the Excessive Deficit Procedure and, especially, the improvement of Romania's financial soundness, the sustainability of the public debt.

Looking ahead, Romania's fiscal revenues should be close to those of the Czech Republic, Poland, Hungary, as a share of GDP, to meet the challenges posed by multiple adverse shocks (climate change, energy transition, the new Cold War in Europe).

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