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EXECUTIVE SUMMARY

The present study is the result of a survey carried out in winter 2009/10 on subsidiaries of Austrian, German or Swiss companies, in partnership with Deutsch-Rumänische Industrie- und Handelskammer (AHK), Wirtschaftskammer Österreich (WKO) and Handelskammer Schweiz-Rumänien (CCER). It reveals the strengths and weaknesses of the Romanian tax environment as they are seen by CFOs and Finance Directors of companies carrying on business in Romania and provides a brief description of the tax environment of Romania as it is perceived by taxpayers.

The main observations in the study in each chapter are:

1 Legislative framework and the degree of tax knowledge of the taxpayers

- in general, taxpayers prove to have a good knowledge of the Romanian tax system;
- tax legislation is perceived as being difficult to understand and to apply;
- the Official Gazette is the primary information channel for tax legislation and tax news;
- formal paperwork required is the first cause of difficulties in complying with the tax legislation;
- investments are currently not encouraged due to the instability and unpredictability of the tax environment.

2 Impact of the tax framework on business decisions

- in general, the level of taxes is acceptable, with the exception of social contributions and local taxes;
- the business areas most impacted by taxes are employment, price setting, general trading activity and investments;
- the most beneficial changes in the tax environment would be:
 - coherence of the tax system and more predictability;
 - elimination of instability in the tax legislation;
 - decrease in the social security rates.

3 Tax compliance and relationship with the tax authorities

- in general, the number of tax declarations/statements and the time requires for their completion need to be decreased;
- the authorities are considered rigid, bureaucratic and unhelpful.

INTRODUCTION

During the past 20 years, Romania has been in a process of continuous modernization in its entirety, a process that involves Romania as a state, its institutions, legal framework and last but not least, its individual citizens. One of the very specific aspects that has changed dramatically is the legal framework concerning taxes and duties. Since everything was owned by the state until 1990, there was no need for taxes or duties (although there were a several of these), not to mention sophisticated names with complicated norms and application.

Nevertheless, since 1990 Romania has been trying to develop a modern tax system in line with the more evolved ones from the European Union. Of course, Romania is still far from such developed states as Germany, Austria, UK or France. However, one has to keep in mind that while those states have a tradition in this respect, Romania had almost no tax system in place for 45 years. Taking this into consideration, one can see how much progress has been made in the field of taxation: it started with the introduction of the profit tax, continued with the adoption of the „more modern“ VAT and nowadays the application of the Merger Directive applicable to reorganization of companies from different EU Member States is implemented.

However, if the legal framework seems to be, if not good, then at least on the right track, the situation is not very appealing when it comes to procedures and compliance. Many declarations and statements need to be filed, most of them still on paper since electronic filing is in its infancy. Amongst other drawbacks, one can mention the attitude of people working for the tax authorities, poorly equipped tax offices and the complexity of procedures, which sometimes leads to weeks being needed for a paper to „travel“ from the ground floor to the second floor.

Since most of the taxes and duties are paid and reported by companies doing business in Romania, all the above-mentioned factors have a significant impact on the business environment. The rationale and the purpose of the present study is to draw a picture of the current tax environment as seen by representatives of the taxpayers and to assess the impact that it has on business conducted in Romania. The survey was conducted through questionnaires filled in by subsidiaries of Austrian, German or Swiss companies in Romania.

The study is split into three main chapters:

- 1 Degree of Knowledge about and Opinion on the Tax Framework
- 2 Impact of the Tax Framework on Business Decisions
- 3 Tax Compliance and Relationship with the Tax Authorities

1 Degree of Knowledge about and Opinion on the Tax Framework

During the last years, however, it is obvious that a modernization process has begun. As such, the most significant pieces of legislation have been united under the umbrella of a single legislative act – the Fiscal Code¹ – which is backed up by quite comprehensive Norms² for its application. Moreover, in 2003, a Fiscal Procedural Code³ was issued, detailing compliance and procedural aspects related to taxation.

The above-mentioned tax acts, which may be regarded as the backbone of the Romanian taxation framework, are accompanied, on the one hand, by several other tax acts, which aim to bring clarifications or amendments to their provisions, and, on the other hand, by tax acts providing for taxes or duties, which are not to be found in the Fiscal Code.

However, what is common to most of the pieces of tax law, if not all, is that they suffer changes each year, and sometimes several times a year. For instance, the Norms for the application of the Fiscal Code have been modified more than 15 times since their initial publication, leading to a severe lack of readability. The Fiscal Code and the Fiscal Procedural Code, to mention only the most important acts, are no different, which sometimes makes the understanding and application of the tax legislation quite burdensome.

The present study has revealed that around 39% of the persons who have responded to the questionnaire designed for the present survey use the Official Gazette as the primary source of information in regarding taxation. However, 44% of the respondents have indicated that the Official Gazette is not among the most-often used three sources of information, which may be surprising, considering that this is the only channel in which official pieces of legislation are published.

The other respondents have indicated as a primary source of information: independent tax advisors (25%) and media & newspapers (14%). The rest use law firms, tax seminars and in-house counselors in equal proportions.

Interestingly, the **majority of the persons** who indicated that they find the information published in the Official Gazette as being satisfactory **also use a secondary or third source of information** (e.g. media, independent tax advisors). An explanation for this situation might be that, in general, the respondents consider that the taxation acts and provisions contained therein are difficult to understand, apply and comply with.

Chart 1 provides a clear picture of how the respondents perceive the difficulties in understanding and applying the legislation.

¹ Law no. 571/2003

² Government Decision no. 44/2004

³ Government Ordinance no. 92/2003

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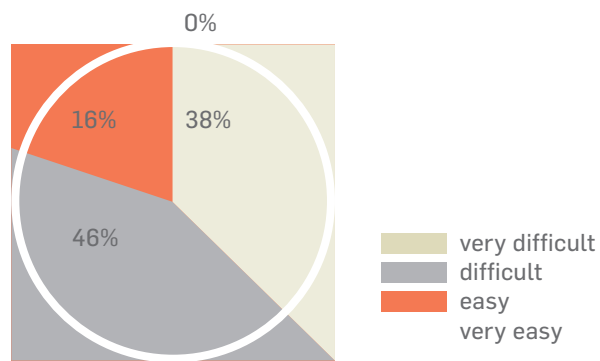


CHART 1
Comprehensibility and application of tax legislation

As may be seen from Chart 1, nobody considered the legislation very easy to understand and apply. This is the main reason why, as mentioned above, respondents that consider the information in the Official Gazette satisfactory always use a secondary source of information about tax legislation changes.

The main reasons indicated as a justification for this unfavorable opinion about the comprehensibility of tax legislation are the frequent changes and unclear provisions of the legislation as well as the regulations for its applications.

Chart 2 shows that more than 70% of the respondents consider that the legislation provides for too much or excessive paperwork and compliance procedures. Also, the legislation seems to generate difficulties itself, since there are too many pieces of law, changing constantly, therefore making it hard to follow and keep up the pace.

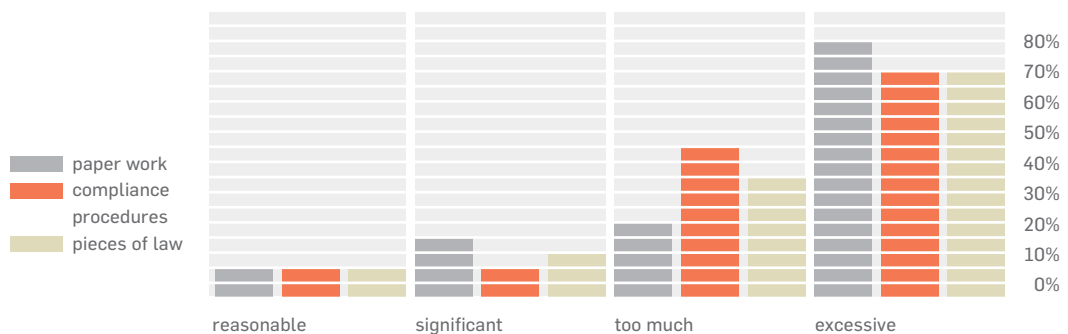


CHART 2
Difficulty in compliance – reasons

This unfavorable opinion about the legislation seems to be even worse when it comes to the tax system and environment in Romania as a whole, as the attributes chosen by the respondents for their characterization are far from being flattering.

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When asked to describe the tax environment considering attributes like “predictability”, “burdensomeness”, “efficiency”, “easy to comply with” and “stability” most of the respondents tend to be moderate, if their opinion is positive in relation to a certain attribute and very harsh, if their opinion is negative. This can be seen in Charts 3 – 7.

not at all
not so
reasonable
very



CHART 3
Predictability

not at all
not so
reasonable
very



CHART 4
Burdensomeness

not at all
not so
reasonable
very



CHART 5
Efficiency

not at all
not so
reasonable
very



CHART 6
Ease of compliance

not at all
not so
reasonable
very

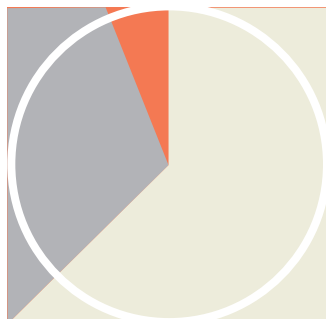


CHART 7
Stability

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Thus, a vast majority – 70% – of the respondents believe that the tax environment is not “predictable”, “efficient”, “stable” or “easy to comply with”.

Stability is the most questionable attribute, since 29% of the respondents see the tax environment as “unstable” and 64% see it as being “very unstable”.

The lack of predictability combined with the lack of stability makes it very difficult for companies to budget or perform forecasts on a medium or long term.

2 Impact of the Tax Framework on Business Decisions

Regarding the impact of the tax environment on the companies of the respondents, respondents take moderate positions.

As such, when it comes to the **level of taxes** applicable to the business they represent, surprisingly, most of them consider this level as being **in general fair**, with certain exceptions such as local taxes or the health contributions.

Please see Chart 8.

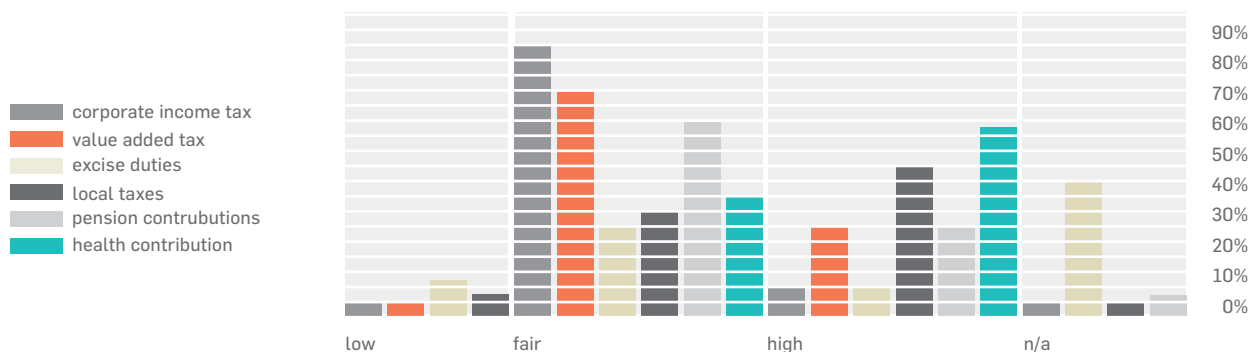


CHART 8
Level of taxes

It seems that most of the respondents agree that the current levels of the corporate income tax and VAT are acceptable. Most of the answers claiming that the VAT rate is high come from respondents, who ask for reduced VAT rate for certain activities such as construction or production of /trade in food products.

The level of contributions to the pension system is considered by the majority fair, which might be a surprise, since the **contributions to the health system**, amounting to approximately one third of the latter, are seen as “**high**” by more than 60% of the respondents.

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When asked to estimate what impact taxation has on business decisions (Chart 9), most of the respondents agreed that the decisions on "human resources", "fixing prices/fees" and, surprisingly, "financing of activities and investments" are the most impacted. If this is normal in the human resources and pricing fields, since a change in taxes would immediately be reflected in personnel or operating costs, investments should nevertheless not be much affected, since investments are made usually on medium/long term, with medium/long term impact. If this is corroborated by the fact that the tax environment is seen by more than 80% of the taxpayers as neither "stable" or "predictable", **one could draw the conclusion that there is no real incentive to invest in a business in Romania nowadays from a taxation point of view.**

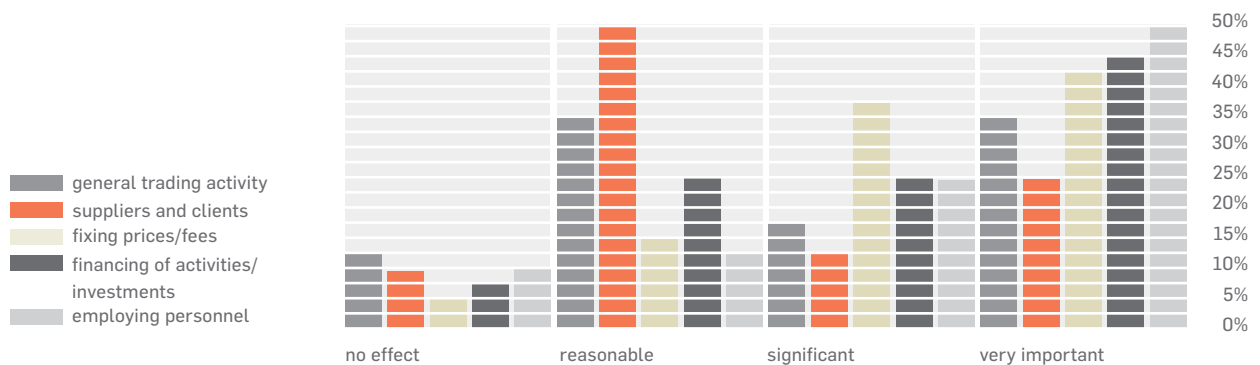


CHART 9
Impact of taxation on business decisions

With regard to the changes of the tax environment that are most desired by taxpayers, a **coherent and predictable tax policy is the most important**, followed by an improvement in the stability of the tax legislation and a decrease in the social contributions rates. The latter is most likely to be linked with the health insurance contributions, which are considered to be too high.

In order to alleviate the burden upon companies by the tax environment, the respondents have made a ranking of the changes that would be beneficial for the business environment. The desired changes in the fiscal environment, as they were ranked by respondents, are as follows:

- 1 development of a coherent and predictable fiscal policy
- 2 improvement in the stability of tax legislation
- 3 decrease of social contribution rates
- 4 relief in tax compliance procedures
- 5 decrease in corporate income tax rates.

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On the legislative side, the respondents have indicated quite an extensive number of amendments that they consider to be being beneficial for their business; however, most welcomed amendments would be:

- 1 collection of output VAT and payment upon collection of the invoice
- 2 extended deductibility for losses from receivables
- 3 extended deductibility of provisions for bad and doubtful debts
- 4 decrease of salary-related taxes and contributions

Surprisingly, although mentioned a few times, the **repeal of the minimum profit tax introduced in May 2009 is not an amendment many seek.**

The legislative changes desired by the respondents seem to have one common characteristic: they are generated by the economic crisis in Romania and most of them are due to cash shortages. It will be interesting to see whether, in the next years, after the crisis has passed, the respondents' requirements will be maintained.

3 Tax Compliance and Relationship with the Tax Authorities

As already mentioned in section 2 above, the tax environment in Romania is perceived as being "burdensome" and "not easy to comply with". Taking a more detailed look, there are a few elements that lead to this impression, reflected in Chart 10.

The most significant aspect that the respondents have outlined is a very high number of forms that need to be filled in and filed with the tax authorities, which in turn lead to a significant amount of time that needs to be spent in order to be fully compliant with the legislation.

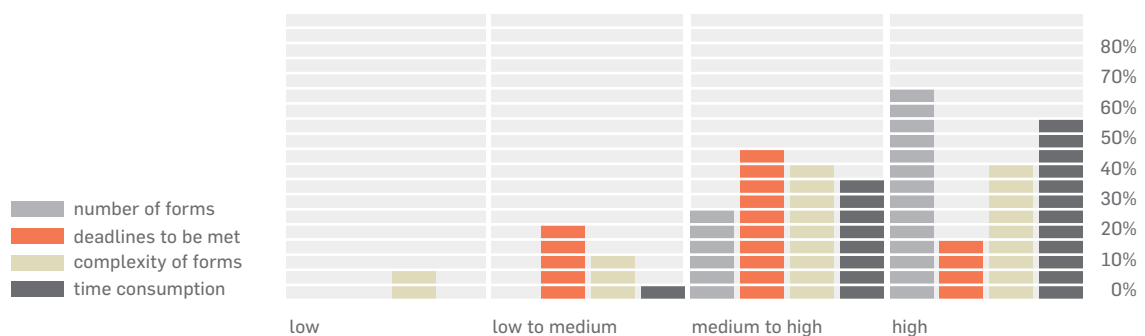


CHART 10
Perception of tax compliance requirements

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The complexity of forms is also seen as being quite burdensome, with more than 40% of taxpayers considering that the tax statements and declarations are difficult to understand and to fill in.

It should be noted that, since Romania's accession to the European Union, the time needed for tax compliance matters seems to have increased. Some (18% of the respondents) are even of the opinion that the time needed has increased significantly. This should not come as a surprise, since only the harmonization of VAT with the EC directives lead to the introduction in the Romanian legislation of several new tax or statistical declarations.

However, there are certain aspects which, if improved, might decrease the tax compliance burden and time consumption. Some of them, as indicated by the taxpayers, refer to legislative changes, and some to changes within the tax authority, as presented below:

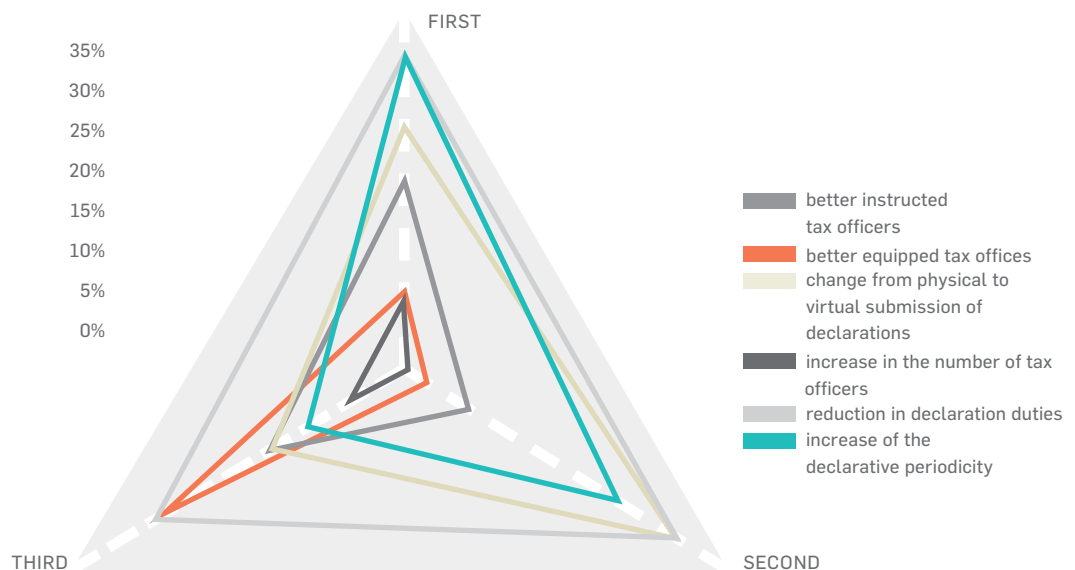


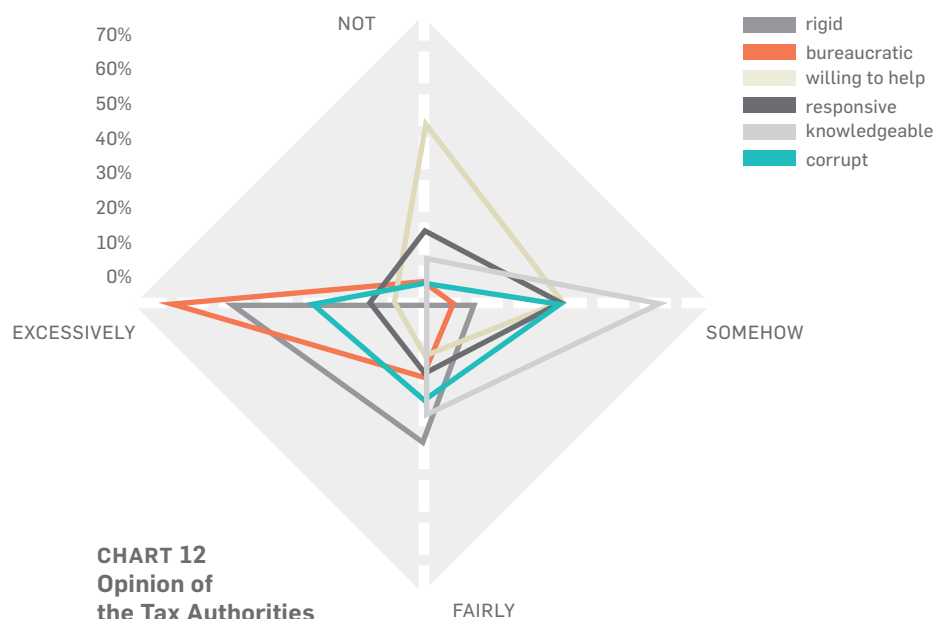
CHART 11
Ranking of means of improvement of tax compliance

As shown in Chart 11, concerning compliance requirements, the most beneficial improvements (ranked either first, second or third) would be a "reduction of declaration duties", followed by the development of "virtual submission of statements" and improvement in the education and training of the tax officers.

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When it comes to the relationship with the tax authorities, taxpayers do not seem to have favorable opinions. The attributes that would best describe the tax authorities seem to be mainly negative ones, such as “bureaucracy”, “rigidity” and “corruption”. There are still some that consider the authorities to be knowledgeable (27%) and responsive (25%); however, they represent a minority (see Chart 12).



It is worrying that taxpayers do not consider the tax authorities willing to help. Although the Fiscal Procedural Code stipulates clearly that „the assistance and guidance of the taxpayers, in what concerns the unitary application of the legislation regarding taxes, duties, social contributions and other budgetary revenues administrated by the National Agency for Tax Administration is to be done by the latter and its subordinated units“, this is not the case in practice.

What may be even more worrying is that a lot of respondents believe that the tax authorities are corrupt.

Considering the bad image the tax authorities have among taxpayers, it is more than necessary that along, with the legislative framework, **the modernization process of the state bodies collecting the taxes and duties is accelerated.**

CONCLUSION

The tax environment of a country has a great influence over its economy. There are countries that have managed to attract investors and to keep them, not necessarily because of their resources or geographical position, but because they managed to develop a healthy economic strategy, backed by a coherent and favorable tax system.

Romania is part of the European Union since 2007. Long gone are the days when Romania could have turned into a tax paradise, be it even for a limited period of time, just to attract investors. Still, Romania as a country has several other advantages, such as location within the EU, access to the Black Sea and competitive labor costs. Based on the overall replies to the survey questionnaire, Romania is not seen as a good country in which to do business, due to several elements such as lack of infrastructure and political instability. One of the reasons invoked by companies is the lack of stability and predictability of the tax system and tax environment in Romania.

It is difficult to start a business and develop it if you are not aware of the country's medium-term tax strategy. Business plans are usually made for periods longer than one year and, in the current context, when tax laws are changed and published within weeks prior to entering into force, a business plan would be faulty from the very beginning.

On the other hand, while the legislation is not too helpful, the tax authorities, through their attitude and behavior, are not helping either. Moreover, the authorities seem to be bureaucratic, rigid, and to a high degree not knowledgeable.

This study has shown that taxpayers want to pay taxes. They also do not necessarily want lower taxes. What they want is coherence, stability and predictability. Taxpayers need to pay taxes more easily, since currently, while they have to budget for taxes, they have to allocate significant organizational costs for employees in charge of calculating and paying the taxes. Last, but not least, investors want the tax authorities' mentality to move towards a "partnership approach" rather than to keep the "policemen approach".

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