

## A LONGITUDINAL ANALYSIS REGARDING THE EVOLUTION OF PROFIT TAX REGULATIONS IN ROMANIA – AN EMPIRICAL VIEW

**Cuzdriorean-Vladu Dan Dacian**

*Babes-Bolyai University, Cluj-Napoca Faculty of Economics and Business Administration*

**Albu Cătălin Nicolae**

*The Bucharest Academy of Economic Studies Faculty of Accounting and Management Information Systems*

**Albu Nadia**

*The Bucharest Academy of Economic Studies Faculty of Accounting and Management Information Systems*

**Fekete Szilveszter**

*Babes-Bolyai University, Cluj-Napoca Faculty of Economics and Business Administration*

*The study conducted a longitudinal analysis regarding Romanian profit tax regulations. Beginning with the first profit tax regulation implemented in 1991 and until now, we analyzed based on an empirical approach all changes that have occurred over time in the Romanian accounting environment. The motivation of the study conducted was based on the strong relationship between accounting and taxation in the Romanian accounting environment over time, the profit tax being one of the main items of this relation. This particular study is divided into five sections. After a short introduction and presenting the motivation of the study (section 1), in section 2 we conducted the literature review based on international and national studies regarding the profit tax regulations through the relationship between accounting and taxation. Section 3 presents a brief review of the main Romanian regulations that concerned the profit tax and the most important changes that have occurred over time. In section 4 we conducted the empirical analysis. In this section is realized a series of analysis, aiming the following: (1) the total number of regulations that have amend the main regulations presented in the previous section; (2) the type of amendments implemented over regulations (abolishment, text amendment, adding new articles or alignments); (3) the total number of amendments approved by law without modifications, respectively the total number of amendments approved on the Official Journal through Government Ordinance or Emergency Ordinance and unapproved by law. The empirical analysis conducted documented that the main shortcoming associated with the profit tax regulation is due by the multiple changes which have been subject of the 5 main profit tax regulations. The last section (section 5) consists in presenting the conclusions of the study. As main conclusion, the profit tax regulation is stable only in terms of the small number of main regulations, the large number of amendments creating difficulties in the understanding and application by practitioners.*

*Keywords: profit tax regulations, longitudinal analysis, Romania*

*JEL Classification: H25, H29, M40, M41*

### **1. Introduction**

The relationship between accounting and taxation is a much disputed subject in the literature and in practice. In the literature, the central point of this relationship is represented by the profit tax, in the next section being realized a brief overview of this aspect.

To may conduct a study regarding the relationship between accounting and taxation is important to know and understand the tax regulation and also the accounting regulation, and in particular the profit tax regulation.

The present study aims to be a starting point for further research regarding the relationship between accounting and taxation in Romania. In this respect, the study conducted a longitudinal analysis regarding the evolution of Romanian profit tax regulation, being conducted an empirical analysis regarding the amendments which have occurred over time. For this reason, a series of analysis was conducted for capture the evolution of the multiple amendments of profit tax regulations.

Section 2 is dedicated to the international and national literature review. This section captures that studies which were conducted in the literature in terms of relationship between accounting and taxation the central point being represented by profit tax. Section 3 presents a brief overview of the Romanian profit tax regulation and their main changes over time. In section 4 is conducted the empirical analysis in order to realize the main objective of the study: *the longitudinal analysis regarding the evolution of Romanian profit tax regulations*. Section 5 concludes the study.

## **2. Literature review**

No study was conducted until now regarding the longitudinal analysis of profit tax regulations. As we mentioned above, the profit tax is one of the main item of the relationship between accounting and taxation. Thus, in the next paragraphs of this section we will analyze such paper which has captured this aspect based on international and national studies.

Hoogendoorn (1996) conducted a study which realized an overview of 13 EU Countries regarding the relationship between accounting and taxation, based on the distinction between those 2 Accounting Systems (Anglo-Saxon and Continental accounting systems), as well as, the connection and disconnection between accounting and taxation regarding deferred tax as part of profit tax. The conclusion of the study was that there are significant differences between countries from this point of view.

Lamb *et al.* (1998) identified 5 possible cases of the relationship between accounting and taxation. These cases were tested on 4 countries (Germany, France, UK and US), using 13 factors which had a different behavior depending by the type of accounting system of each country. These factors (such as: depreciation, adjustments, fixed assets recognition and evaluation, etc.) have different behavior in the determination of the tax base for profit tax. Based on this study, Nobes *et al.* (2004) realized a comparison between Spain and countries included in the study conducted by Lamb *et al.* (1998). Nobes and Schwencke (2006) conducted the same analysis on Norway case and Gee *et al.* (2010) conducted a comparative analysis between Germany and UK. In Romania, Fekete *et al.* (2009) and Cuzdriorean *et al.* (2010) have been realized an empirical analysis of the relationship between accounting and taxation. In their analysis they included the profit tax as tax factor that influence the turnover as accounting factor. Based on those studies, Fekete *et al.* (2010) tested the empirical model on SMEs cases using the same items (profit tax and turnover). These papers found a relationship between profit tax and turnover, but the model show that a lot of other factors influence the accounting. In this respect, we conclude that it would be necessary if we would find the individual factors which influence the tax base of profit tax (based on study conducted by Lamb *et al.* (1998), plus other specific factors for Romanian environment). Thus, as we mention in the previous section, this paper may be a step of other research regarding the relationship between accounting and taxation, as well as for the measuring the influence of taxation over accounting or accounting over taxation.

### 3. Brief review of the profit tax regulations in Romania

The starting point for the term of profit and also for profit tax in Romania was year 1990. Through The Government Decision no. 741/1990 was introduced the term of *tax benefit*. Thus, for the first time in Romania, after the communism era, based on article no. 2 from the present Decision:

“The tax benefit is due by economic entities, and also by centrals, big entities, trusts, small companies and other assimilated entities ...”

The same Decision, affirm that:

“The entities provided on article no. 2 from the present Decision not perform payments from their benefits to the State budget” (article no. 3)

The term of *tax benefit* was changed through the Law no. 12/1991, when appear for the first time the term *profit tax*. From 1991 until now, the main profit tax regulation was amended by other 3 times (**Figure 1**). These regulations were also amended by a lot of other regulations, the empirical analysis of this situation being realized in the next section.

**Figure 1.** The main profit tax regulations in Romania

Regulation	Government Decision No. 704/1991	Law no. 12/1991	Government Ordinance no. 70/1994	Law no. 414/2002	Law no. 571/2003
Period	1990	1991-1994	1995-2002	2002-2003	2004-present

Source: Authors projection

From 1991, the year of appearance of profit tax regulation, a lot of amendments have been produced over the regulations. **Table 1** illustrates a brief overview of the main important amendments that were produced over time.

**Table 1.** Evolution of the main profit tax regulations in Romania

Period	Tax Regulation	Effective date	Main changes introduced
1991-1994	Law No. 12 / 30.01.1991 on the profit tax	January 1, 1991	Progressive tax was applied, with a total of 67 tax cuts Tax cuts were between 2.5% and 77%, with a profit of 25,000 lei, relieved from duty Taxable profit was calculated as the difference between revenue received and expenditure provided by law
	Government Decision No. 804 / 30.11.1991 on the profit tax	January 1, 1992	Progressive rates were reduced to two rates, as follows: 30% for a taxable profit under 1 million lei 45% for a taxable profit over 1 million lei
1995-2002	Government Ordinance No. 70 / 29.08.1994 on the profit tax	January 1, 1995	Profit tax rate was set at 38% Differential tax rates were applied for certain categories of taxable persons A distinction between small and large taxpayers is made; the tax base was established depending on the category of taxpayer Concepts of tax-free income and non-deductible expenses are introduced; unclear setting conditions were established for tax-free revenue For certain expenses partial deduction was applied (e.g. for gifts and subsidies granted were established tax-deductible limit set by law)
	Government Ordinance No.	January 1,	Elimination of the distinction between small and

	70 / 29.08.1994 on the profit tax, republished	1997	large taxpayers Elimination of the distinction between accounting depreciation and tax depreciation
	Government Emergency Ordinance No. 217 /29.12.1999	January 1, 2000	Profit tax rate was set at 25% Explanations were provided for the total deduction or partial deduction of expenditure included in the calculation of taxable income. The concept of taxable income is reintroduced; it may occur for property revaluation
2002-2003	Law No. 414 / 26.06.2002 on the profit tax, 1994 <sup>(2)</sup>	July 1, 2002	Taxable profit = total revenue - total expenses – tax-free revenue + non-deductible expenses The categories of free-tax revenue were defined
2004 - present	Law No. 571 / 22.12.2003 on the Fiscal Code	January 1, 2004	Taxes and fees due to the state budget and local budgets are regulated, income taxes being regulated under Chapter II of this Law The categories of free-tax revenue, deductible expenses, partially deductible expenses, and fully non-deductible expenses are distinctly regulated Distinction between accounting depreciation and tax depreciation The amount of reserves that can be deducted in the determination of taxable income and tax deductible provisions is distinctly regulated The determination of the deductibility of interest expenses and the foreign exchange losses is distinctly regulated Tax credit concept is introduced; the most common tax credit is represented by the deduction of the gifts and subsidies expense from profit tax, granted in the amount according to law
	Government Emergency Ordinance No. 138 /29.12.2004	January 1, 2005	Profit tax rate was set at 16%
	Government Emergency Ordinance No. 34 / 11.04.2009	May 1, 2009	Introduction of the minimum tax which is applied on companies revenues obtained in the previous year, whether or not they obtain profit The deductibility of expenses for certain sectors, such as fuel expenditure, value added tax related to the purchase of cars, was eliminated The tax measures apply until 31.12.2010

Source: Authors projections based on Fekete *et al.* (2010)

#### 4. Empirical analysis regarding the amendments of the profit tax regulations

The methodology that we used in the empirical analysis is based on the longitudinal view regarding the total number of amendments which were produced over time in terms of profit tax regulations.

The information's regarding the profit tax regulations were obtained from the Official Journal of Romania ([www.moficial.ro](http://www.moficial.ro)), and from the official site of the Chamber of Deputies, ([www.cdep.ro](http://www.cdep.ro)).

In this respect, to obtain the answer to this problem, we conducted an analysis that consisted in the counting of the regulations that have amended the main profit tax regulations. The answer of the main problem of our research, was obtain based on the following research questions:

*Q1: Which is the total number of regulations that have amended the main profit tax regulations?*

*Table 2. The number of regulations which amended or proposed amendments of the main profit tax regulations*

	Total, that comprised	Government regulations approved by law without amendments	Government regulations approved by law with amendments	Laws which amended the Government regulations	Regulations that have a direct amendment*	Government regulations rejected by law	Government regulations which are not yet adopted
Law no. 12/1991	5	0	0	0	5	0	0
Government Ordinance no. 70/1994	5	3	0	0	2	0	0
Government Ordinance no. 70/1994, republished	23	7	4	4	4	4	0
Law no. 414/2002	3	1	1	1	0	0	0
Law no. 571/2003	21	10	4	4	2	0	1
<b>TOTAL</b>	<b>57</b>	<b>21</b>	<b>9</b>	<b>9</b>	<b>13</b>	<b>4</b>	<b>1</b>

Source: Authors projections

**Table 2** shows that a total number of 57 regulations amended or proposed amendments of the main profit tax regulations. The highest percentages are represented by the Government regulations (Government Ordinance or Emergency Ordinance) (21 regulations), respectively 13 regulations that have a direct amendment (\* there are included those regulations, which did not approve the amendments made by other regulations). There is also, an approval amendment of Law no. 571/2003 (Emergency Ordinance no. 117/2010) which is not net adopted.

*Q2: Which is the type of amendments implemented over regulations (abolishment, text amendment, adding new articles or alignments)?*

**Table 3** illustrates that a number of 168 proposals of amendments were made over the 3 main regulations (over Law no.12/1991 no amendment proposal was made). A percentage of 50% (84 of 168 proposals) of the total proposals represents the articles amendments (change the existing text articles of the main regulations). The gray part of **Table 4** illustrates that a total number of 43 amendments approve without proposals (Regulations that have a direct amendment); in this case, 70% of amendments are represented by articles amendments (30 of 43 amendments).

**Table 3. The total proposal of amendments**

Profit tax regulation	Total proposal of amendments, that comprised	Articles amendments	Abolishment	Completion
Law no. 12/1991	0	0	0	0
Government Ordinance (GO) no. 70/1994	2	2	0	0
Government Ordinance (GO) no. 70/1994, republished (r)	53	13	14	10
Law no. 414/2002	8	6	0	2
Law no. 571/2003	105	63	16	26
<b>TOTAL</b>	<b>168</b>	<b>84</b>	<b>30</b>	<b>38</b>

Source: Authors projection

*Q3: Which is the total number of amendments approved by law without modifications, respectively the total number of amendments approved on the Official Journal through Government Ordinance or Emergency Ordinance and unapproved by law?*

The answer of this question is received from data collected in **Table 2**. Thus, a total number of 21 Government regulations approved by law without amendments which amended a total number of 133 through proposals, which represent 61,29% from the total proposals (based on **Table 4**).

**Table 4** contains also the amendments to the proposals (23 amendments) and the completion to the proposals (10 regulations completion, 5 regulations amendments and 3 repelling (abolish). These were made by 9 Government regulations approved by law with amendments, plus 9 Laws which amended the Government regulations.

**Table 4. The total approvals amended by regulations**

	Total approvals, that comprised	Amendments approves through proposals	Amendments to the proposals	Completions to the proposals			Amendments approve without proposals, that comprised	Articles amendments	Abolishment	Completion
				Regulations completion	Regulations amendments	Abolishment				
Law no. 12/1991	10	0	0	0	0	0	10	9	1	0
GO no. 70/1994	8	2	0	0	0	0	6	3	0	3
GO no. 70/1994, r	56	31	15	3	1	0	6	5	1	0
Law no. 414/2002	9	4	4	1	0	0	0	0	0	0
Law no. 571/2003	134	96	4	6	4	3	21	13	2	6
<b>TOTAL</b>	<b>217</b>	<b>133</b>	<b>23</b>	<b>10</b>	<b>5</b>	<b>3</b>	<b>43</b>	<b>30</b>	<b>4</b>	<b>9</b>

Source: Authors projection

## 5. Conclusions

As a result of the analysis conducted, we can conclude that the profit tax regulation is stable only in terms of the small number of main regulations (5 regulations over time), the large number of amendments creating difficulties in the understanding and application by practitioners. During the 20 years of the analysis, a total number of 217 approvals were amended the profit tax regulations, which were made by 57 regulations (56 which were adopted, and 1 which were not yet adopted). As a weight of the amendments, around 11 amendments were approved each year, this showing that the profit tax regulations are dominated by instability.

As further research, we will analysis the types of the amendments, based on 3 directions: (1) the direct influence analysis (amendments with effect over all type of taxpayers) and indirect influence; (2) the text analysis of amendments, in this respect being conducted other statistical analysis, based on the social impact produces by regulations (e.g. the effects of crisis in terms of regulations); (3) the type of amendments (e.g. the tax base, the tax rate, etc.).

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