Is it time to change the taxation of income from wages?

Foreign Investors Council

Objective

Romania has been in the excessive deficit procedure since 2019, and the reduction of the budget deficit is a pressing issue. In recent years, several fiscal measures have been mentioned in the public and political space, including the reform of labour income taxation. The FIC believes that the basis of any decision must be an impact analysis, which is complete and focused on the medium-long term.

With this document, we want to outline a first overview of the economic context of Romania, some possible scenarios, practices in other EU countries, some proposals from the FIC, but also the summary of the recommendations of the World Bank, Organisation for Economic Co-operation and Development (OECD), International Monetary Fund (IMF), and the European Commission on the subject of labour income taxation. This short analysis is a first basis for future debates, but for a complete picture, the effect of such a measure on total budget revenues must be quantified, as well as the effect on the economy. At the same time it should be taken into account that various categories of budget revenues have different elasticity coefficients.

Introduction

General remarks and context:

- Romania has been in the excessive deficit procedure since 2019 and the reduction of the budget deficit is a pressing issue. However, any tax reform should be comprehensive and be made simultaneously taking into account several factors: ensuring the efficiency of spending, reducing tax evasion and only then an increase in taxation.

- Any change in taxation must quantify its effect on both total budgetary revenues and on the economy. Various categories of budget revenues have different elasticity coefficients.

- The theme of the progressive tax versus the flat tax rate (which no longer exists in the form it was originally thought of in 2005) must be part of a broader discussion on the structure and level of taxation throughout the economy.

- The taxation of salaries in Romania is high, as attested to by all specialised studies. The fiscal burden (tax wedge), that is, the amounts paid in taxes and contributions to the budget, as a percentage of the gross salary, was 37.2% in 2021 vs. the EU average of 31.9% or vs. the OECD average of 34.5%. Romania has the 5th highest tax burden in the EU.

- It is true that Romania has the lowest level of progressivity of the tax burden in the EU, which puts a higher tax burden on those with low incomes. However, increasing the level of progressivity of the tax burden can also be achieved in ways other than introducing progressive rates on income tranches; deductions from the taxable base and its capping can ensure progressivity and corrective regression, aligned with those economic and social policies deemed necessary or desirable to promote.

- It is necessary to estimate the net effect on budget revenues as a result of changing tax levels. Certain categories of budget revenues will be negatively impacted due to the alteration of the level of disposable income. Moreover, an increase in taxation would have a negative impact on economic growth and thus on the total revenues collected by the budget.

- Individually addressed, introducing progressive tax would probably not have the expected accounting effects on the budget and might even have negative repercussions in the economy, including the emigration of skilled labor, the growth of the underground economy, etc.

- The structure of the taxation of income from salaries and income associated with salaries must support economic growth and be rethought in accordance with the medium-long term development objectives.

- Analysis of the structure of taxes and duties should be made in relation to competitiveness —especially with countries in the region, with a focus on labour costs, net real earnings and the redistributive effect of taxes. This analysis must be complete, not just related to certain isolated elements, such as statutory rates, while ignoring the other relevant parameters.

- The discussion on the focus of taxation, i.e.capital or labour, needs to be looked at more deeply from the perspective of automation/digitalization and climate transition – with the latter soon to bring additional taxes to the economy, i.e, ETS2, CBAM, which will affect Romania's competitiveness.

- An increase in labour taxation would also have an impact on staff salaries supported by the public budget. Moreover, if the government raised public sector salaries to compensate for increased taxation, this would mean higher budget spending which would cancel out the benefits of increased revenue from tax.

- Romania must reduce its budget deficit in the coming years and this needs to be done both through an adjustment of expenditure and through measures to reduce tax evasion.

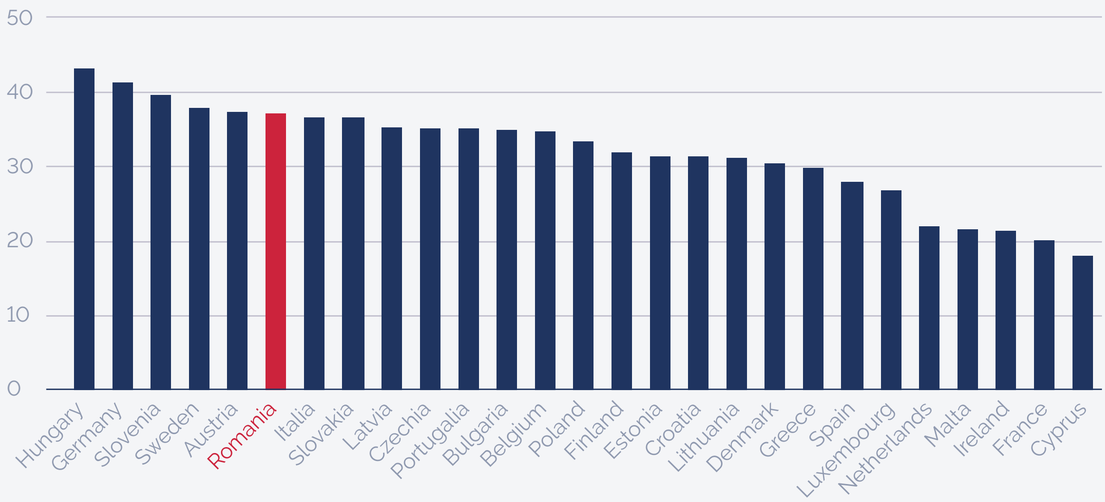
- Prior to any decision to change the tax system, the objective of this change needs to be discussed, because neither the effect of increasing tax revenues, nor the redistributive and diminishing effect of economic inequalities, as a potential result, certified by analyses based on empirical data, but rather disproved by published studies. Moreover, recent studies indicate that if the redistributive effect of taxation is the targeted objective of the measures, then there is no evidence of achieving this goal, there are actually analyses that support the exact opposite[1].

1 Informality, Consumption Taxes, and Redistribution, 2022, Pierre Bachas, ESSEC Business School, France and World Bank Research, USA, Lucie Gadenne, Queen Mary University of London, Institute for Fiscal Studies and CEPR, UK, and Anders Jensen, Harvard Kennedy School and NBER, USA - https://acrobat.adobe.com/id/urn:aaid:sc:eu:4955ada1-9948-46d9-b01b-54046e44dcd0

Taxing the workforce

Romania has one of the highest tax burden rates in the EU. The tax burden, calculated as the percentage of taxes and contributions paid to the state as a percentage of gross pay, is in the top third of EU countries.

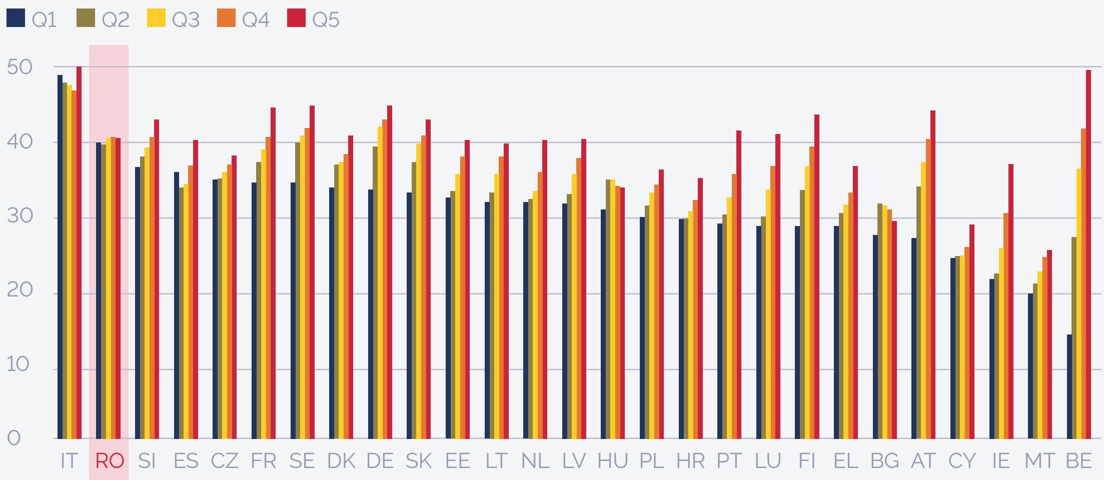
Tax burden in EU countries in 2021, %



SOURCE
Eurostat. For a single-person family, with 50% of the average income, no children

Another issue is that in Romania the level of the tax burden is the most flattened, relative to the revenue quantiles, compared to other EU countries. There are potential solutions for introducing a certain level of progressivity, such as tax credit or tax deductions, for example. This solution would help those with low incomes without having to change the income tax rate, because the latter measure could have significant negative repercussions on economic growth.

Level of tax burden according to income from quintile salaries (2022)



SOURCE
European Commission, Annual Tax Report, 2023

Within the National Recovery and Resilience Plan (NRRP), Romania has assumed several objectives on taxation, i.e.:

NRRP - tax reform

The overhaul of the tax framework in Romania will be carried out through 4 milestones, and the aim of the reform is to improve the tax revenue structure and increase tax revenues as a percentage of GDP by 0.5 percentage points by 2025.

The main measures taken by Romania through the NRRP include:

a. Phasing out tax incentives and tax gaps in income tax, corporate tax (including special schemes that may be subject to derogations).

b. Orientation of the tax regime towards the application of ecological taxes.

c. Modification of the micro-enterprise tax system.

d. Exemption from profit tax for reinvested profit.

e. Equal tax treatment for dividends paid by a Romanian legal entity to both a Romanian legal entity and a legal entity resident in the EU.

f. A change in the tax rate of dividends distributed to Romanian legal entities, as well as to other entities.

g. For incomes from salaries and assimilated to salaries, the establishment of a monthly ceiling of non-taxable income and not included in the calculation base of mandatory social contributions, of not more than 33% from the basic salary corresponding to the job.

h. Modification of the taxation of income earned by individuals from the disposal of the use of goods, as well as those from gambling.

i. Establishing goods and services for the application of reduced VAT rates.

j. A new excise duty rate calendar covering the amount and period of application of the excise duty rate for products subject to the harmonised excise duty procedure.

k. Updating the level of excise duties for alcohol and alcoholic beverages, which have not been updated since the rewriting of the Fiscal Code.

l. Ensuring similar treatment for heated tobacco products as that for processed tobacco products by introducing a timetable for a gradual increase in excise duty rates.

m. Modifying the determination of the taxable amount for buildings and land and achieving a fairer taxation mechanism.

Even though most international institutions recommend an increase in the level of income tax (see Appendix 1), such a measure must be considered more deeply, including from the perspective of the current development stage of the Romanian economy.

Simulations

The simulations below are intended to highlight four tax rate scenarios (10%, 16%, 25%, and 15%) for different income categories in Romania. These simulations represent indicative data, to provide a first image on possible scenarios and a first impact assessment, without being a complete analysis detailing all of the forms of income that have different elasticity coefficients and effects.

Thus, in the first table we observe the calculated annual net income for each type of income, taking into account the levels of gross income. For example, for a gross income of RON 44,400, the annual net income for an employee is RON 31,140, for a PFA RON 28,431, for income from intellectual property rights RON 43,254, and for a micro-enterprise RON 29,642.

The second table also presents the total tax amounts paid for different forms of employment or economic organisation structures in Romania, at different annual gross income levels. In this respect, we compare the tax burden for employees, for PFAs, for income from intellectual property rights and for micro-enterprise or corporate income tax payers. For example, if we look at a gross annual income of RON 72,000, we see that the total taxes for each category are RON 31,233 for salaried employees, RON 24,615 for PFAs, RON 6,750 for IPR income and RON 20,639 for micro enterprises. This data helps us understand the amounts that each type of employee or business would pay in taxes, given the level of income.

Table III shows the percentage of taxes paid (% taxes) in relation to annual gross income for the four income categories. For example, for a gross annual income of 120,000 lei, the tax rates are 44% for employees, 37% for PFAs, 20% for income from IPR and 25% for micro enterprises.

Gross annual income (RON)	**Annual net income**			
	Salary	PFA	IPR	Micro /CIT
44,400	31,140	28,431	43,254	29,642
48,600	32,586	32,805	48,330	29,588
60,000	35,853	37,665	53,970	34,549
72,000	42,387	47,385	65,250	44,161
84,000	49,140	57,105	61,950	53,773
96,000	56,160	66,825	73,230	60,955
108,000	63,180	65,610	84,510	70,567
120,000	70,200	75,330	95,790	77,749
1,500,000	877,500	1,306,260	1,375,980	1,004,513
3,000,000	1,755,000	2,656,260	2,785,980	2,025,113

Gross annual income (RON)	Total tax			
	Salary	PFA	IPR	Micro/CIT
44,400	18,473	20,169	5,346	18,959
48,600	22,629	21,195	5,670	19,013
60,000	25,497	22,335	6,030	19,451
72,000	31,233	24,615	6,750	20,639
84,000	36,750	26,895	22,050	21,827
96,000	42,000	29,175	22,770	25,445
108,000	47,250	42,390	23,490	26,633
120,000	52,500	44,670	24,210	30,251
1,500,000	656,250	193,740	124,020	345,487
3,000,000	1,312,500	343,740	214,020	674,887

Gross annual income (RON)	% tax			
	Salary	PFA	IPR	Micro/CIT
44,400	38%	42%	11%	39%
48,600	42%	39%	11%	35%
60,000	42%	37%	10%	32%
72,000	43%	34%	9%	29%
84,000	44%	32%	26%	26%
96,000	44%	30%	24%	27%
108,000	44%	39%	22%	25%
120,000	44%	37%	20%	25%
1,500,000	44%	13%	8%	23%
3,000,000	44%	11%	7%	22%

Tax rates in other EU countries

Examples of tax rates, fixed or progressive, in EU countries include, in addition to payroll tax, other types of taxes such as non-salary income tax, dividend tax, property tax, taxes on rents etc.

Tax rates in other EU countries

Income tax in EU countries

- Progressive income tax: Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovenia, Spain, Sweden.
- Flat-rate income tax: Bulgaria, Estonia, Hungary, Romania.

Dividend tax

- Austria, Belgium, Finland, Germany, Ireland, Italy, Portugal, Slovenia and Sweden have the highest dividend taxes (between 25% and 35%).
- At the other end of the spectrum are countries with zero taxation: Cyprus, Estonia, and Malta do not apply dividend taxes.
- Romania has one of the lowest dividend tax rates, along with Bulgaria, Croatia, France, Greece, and Hungary.

Country	Personal income tax (including wage income)	Taxes on rental income	Dividend tax
Austria	Progressive Maximum rate 55% (over EUR 1,000,000)	It is globalised and taxed with personal income tax	27,5%
Belgium	Progressive Maximum 50% (over 46,440 EUR) A municipal surcharge may apply	It is globalised and taxed with personal income tax	30% (20% for repurchased shares)
Bulgaria	Fixed rate 10% 15% for authorised individuals *(sole traders)*	10%	5%

Country	Personal income tax (including wage income)	Taxes on rental income	Dividend tax
Croatia	Progressive Maximum 30% (over 47,780.28 EUR) Income from independent activities: 18% if the gross income is over 995,421.06 EUR	10% plus city tax	10%
Cyprus	Progressive Maximum 35% (over 60,000)	The general income tax rule applies	0% (or 17% defence contribution)
Czech Republic	Progressive rates of 15% and 23% (the 23% rate applies to the part of the income exceeding four times the average annual salary)	It is globalised and taxed with personal income tax	15% EU/EEA residents, 35% others
Denmark	Progressive Up to 52.07% effective (including municipal and other taxes, but excluding church taxes and labour market contribution) (over DKK 568,900) 27% of income from shares not exceeding DKK 58,900 (42% of any excess) Municipal income tax - on average 25.018% Church taxes - on average 0.661% (members only)	It is globalised and taxed with personal income tax	27% (or 15% if holdings are less than 10%)
Estonia	Flat-rate 20%	It is globalised and taxed with personal income tax	0%
Finland	National taxes: • earned income (i.e. from employment and as part of an enterprise's income): progressive - maximum rate 44% (over 85,800 EUR); • capital gains: progressive - 30% (up to 30,000 EUR) and 34% of surplus; • municipal tax on wage income: flat rate 4.36%-10.86%, depending on the municipality; • church taxes on earned income: flat rate 1%-2%, depending on the municipality.	It is globalised and taxed with personal income tax	35%

Country	Personal income tax (including wage income)	Taxes on rental income	Dividend tax
France	Progressive Maximum 45% (over 168,994 EUR) Additional contribution over 250,000 EUR	It is globalised and taxed with personal income tax	12,8%
Germany	Progressive Maximum 45% (over 277,826 EUR) 5.5% solidarity surcharge on tax due over 17,543 EUR (35,086 EUR if assessed jointly); always on withholding tax	It is globalised and taxed with personal income tax	25%
Greece	Progressive Maximum 44% (over 40,000 EUR)		5%
Hungary	15% flat rate 9% entrepreneurs' tax	Flat-rate tax on rentals for tourism purposes	15%
Ireland	Progressive Maximum 40% Applies 0.5%-8% universal social tax (for employees and executives) and 0.5%-11% universal social tax (self-employed)	It is globalised and taxed with personal income tax	25% (0% for EU residents)
Italy	Progressive rates, maximum 43% (over 50,000 EUR) + surcharges	It is globalised and taxed with personal income tax	26%
Latvia	Progressive • Up to 20,004 EUR: 20% 20,004 EUR – 78,100 EUR: 23% • 20,004 EUR - 78,100 EUR: 23% • Over 78,100 EUR: 31% Reduced rate of 15% (optional) for foreigners with remote work visas for certain types of income (subject to additional conditions):	20% up to 20,004 EUR 23% between 20,004 EUR - 78,100 EUR 31% over 78,100 EUR	20% overall
Lithuania	Progressive rating: • 20% on earned income not exceeding 60 average monthly salaries per year (101,094 EUR for 2023); and • 32% on employment income exceeding 60 average monthly salaries per year	15%	15%

Country	Personal income tax (including wage income)	Taxes on rental income	Dividend tax
Luxembourg	Progressive Maximum 42% (over 200,004 EUR) In addition, there is a surcharge of 7% or 9%.	It is globalised and taxed with personal income tax	15%
Malta	Progressive Maximum 35% (over 60,001 EUR)	Between 5% and 15%	N/A
Netherlands	Progressive Maximum 49.5% (over 73,031 EUR)	32%	15%
Poland	Progressive Maximum rate 32% (over 120,000 PLN) Solidarity levy 4% (over 1 million PLN)	8.5% if annual rental income does not exceed 100,000 PLN. 12.5% applies to this income	19%
Portugal	Progressive • Maximum 48% (over 75,009 EUR) • 60% (unjustified increase in wealth of over 100,000 EUR) • Solidarity tax of 2.5% and 5% on incomes exceeding 80,000 EUR and 250,000 EUR respectively	28%	28%
Romania	Flat rate 10%	10%	8%
Slovakia	Progressive Maximum 25% (over 41,445.46 EUR)	It is globalised and taxed with personal income tax	7%
Slovenia	Progressive Maximum 50% (over 74,160 EUR)	25%	25%
Spain	Progressive Maximum 26% (over 200,000 EUR)	19% withholding tax on rentals from urban properties. The rest is globalised and applied along with with personal income tax at a progressive rate.	19%
Sweden	Progressive Maximum 20% (over 598,500 SEK) Single municipal tax of around 32.24% (depending on the municipality)	It is globalised and taxed with personal income tax	30%

The complexity of progressive income tax systems in other european countries.

The examples of Germany, Spain and the Netherlands

The actual progressivity, in terms of effective versus statutory rates, of tax systems in EU member countries - which Romania tends to emulate, is extremely difficult to determine or assess. In fact, the progressive statutory rates provide extremely limited information, as the tax systems are very complex, because the other elements that have an impact on the effective rates (deductions from the tax base with income tax, tax base caps for social contributions) are numerous and complex, distorting any comparison. We present below some relevant examples.

Germany

Payroll taxation and social security contributions

> Germany has a progressive payroll tax scheme with rates ranging from 14% to 45%. For an annual income over 62,809 EUR, the rate remains 42% until the annual ceiling of 277,825 EUR is reached, when the applicable rate is 45%.
>
> However, the employee's net wage income in relation to the total employer's cost never falls below the minimum possible level of 55.14% (i.e. not very far from the 58.85% that Romania can report at any level of gross wage income or employer's cost of remuneration). Of course, in determining this indicator, we also take into account the compulsory social insurance scheme, which includes pension insurance, unemployment benefits, health insurance, disability and old-age care insurance. The above types of insurance are generally financed by equal contributions from employers and employees.
>
> In fact, it is remarkable that in Germany the real net wage income in relation to the employer's cost is generally much higher than this theoretical minimum possible (about 55%), while the maximum marginal tax rate is 45% (much higher than the 10% applicable in Romania) for the following reasons/ factors that significantly change the tax result:
>
> - The existence of an annual gross non-taxable income applicable when determining the taxable base for any employee (this was 10,347 EUR in 2023 and increased to 11,604 EUR in 2024).
> - The possibility of deducting expenses necessary to earn income up to a limit of 1,000 EUR per employee per month. As a result, gross monthly wage income below 1,300 EUR is tax-free.
> - The cap on social security contributions as follows:
>   - Maximum 773.8 EUR monthly pension and unemployment contributions
>   - Maximum 518.7 EUR monthly health contributions
>   - Health contributions are capped at a maximum income of 4,987.5 EUR

    - Pension and unemployment contributions are capped at a maximum monthly income of 7,300 EUR

- Special flat tax rates for low-income employees. For incomes up to 520 EUR per month, the rate is:

    - 2% (this percentage includes the solidarity surcharge and church taxes, if applicable) if the employer pays social security contributions for the employee.

    - 20% plus a 5.5% solidarity surcharge and church taxes in other cases. For earnings up to 120 EUR per day (72 EUR before 1 January 2020) and no more than 18 consecutive days of work, the rate is 25% plus the solidarity surcharge and church taxes where applicable.

- Exemption from tax of overtime bonuses for work on Sundays, public holidays, and at night, provided that they are paid in addition to the basic wage and do not exceed a certain percentage of the basic wage.

- The existence of a tax-free inflation compensation bonus (granted by the employer in cash or in-kind) up to a total amount of 3,000 EUR until December 31, 2024.

As mentioned above, taxable wage income is calculated by reducing gross compensation (salary including all taxable benefits) by expenses. Employees may deduct all expenses incurred in earning and maintaining income, in some cases subject to certain limits. If the expenses do not exceed 1,230 EUR (1,200 EUR before 1 January 2023), an employee is entitled to a standard deduction of 1,230 EUR (1,200 EUR before 1 January 2023) for income tax globalisation.

For example, there is a special flat-rate deduction for commuting expenses of 0.30 EUR per kilometre. The maximum flat-rate deduction is 4,500 EUR for commuters using a means of transportation other than a car. If the employer does not reimburse the commuting costs, the employee is entitled to claim a flat-rate deduction of 0.30 EUR per kilometre as an income-related expense.

Moving costs incurred during employment are professional expenses and can therefore be reimbursed by the employer. This reimbursement is not subject to income tax. If the employer does not reimburse the moving costs on a tax-free basis, the costs are deductible as business expenses if they are incurred as a result of the relocation by the employer to a new main place of employment or in connection with the taxpayer starting a new job. Job mobility is supported and encouraged. Thus, having a dual household requires an employee to maintain residences, one for the family and one for the relocated employee. Travel expenses, living expenses, and lodging expenses are considered necessary expenses related to maintaining two residences for employment purposes. Up to certain limits, these expenses may be reimbursed without being subject to income tax.

Costs of up to 1,260 EUR for the taxpayer's home office are deductible if there is no other place available for the taxpayer's professional activities.

Benefits in kind received by employees are included in earned income and taxed accordingly. If the employer grants the benefit at a reduced price, the benefit is valued at the difference between the amount paid by the employee and the market price. However, no income tax is levied if the difference does not exceed 50 EUR per month for all benefits received.

The fee paid by an employer to an employee for childcare is tax-free if it is in addition to the normally agreed salary.

For all these reasons, the net income of an employee earning a gross income of 1000 EUR represents 70.6% of the employer's cost and no employee falls below 54% of gross, whether they earn 10,000 EUR gross monthly or 20,000 EUR gross monthly, but as a rule, if they use the tax facilities conferred by law, significantly more.

Spain

Income taxation

Progressive tax rates in Spain start at 19% and go up to 47%. Members of a family unit can opt for joint taxation.

The concept of globalised income includes income in six basic categories according to source or origin,i.e.:

- Labor income (rendimientos del trabajo);
- Income from movable capital (rendimientos del capital mobiliario);
- Income from real estate capital (rendimientos del capital inmobiliario);
- Business income (rendimientos de actividades económicas);
- Capital gains (ganancias y pérdidas patrimoniales);
- Imputed income (imputaciones de renta que se establezcan por ley).

For the purpose of calculating the tax, the taxpayer's income in the various categories is divided, as appropriate, into two types of income, i.e.:

- General income
- Income from savings

General income is the total of labour income, rental and real estate income, business income and capital gains, including positive or negative capital gains that are not considered as income from savings.

Savings income comprises both (i) income on movable capital (dividends, interest, and cash profits or payments in kind related to life or disability insurance contracts) and (ii) positive or negative capital gains arising from the transfer of assets.

The general income base is the general tax base minus the following deductions:

- Contributions to mutual insurance schemes covering death, widowhood, orphanhood, pensions, accident, sickness or occupational disability, or the granting of benefits for marriage, maternity, childbirth, or death, where such contributions are made by: professionals (i.e. lawyers, doctors and engineers) who have not opted to be covered by the social insurance scheme for self-employed persons.

- Employees with unemployment benefit contributions.
- Self-employed individuals, as long as their contributions relate to the above-mentioned benefits.
- Contributions to private pension schemes and contributions made by an employer (which are charged to the taxpayer as benefits in kind) are deductible by the taxpayer. Alimony and payments to a spouse by court order (court-ordered child support payments are exempt).
- Supplementary allowances, such as employment allowance, assistance or disability allowances.

All the above contributions are deductible up to the lesser of either 1,500 EUR per individual or 30% of the total net income from work and business or professional income (not per family unit and taking into account both employer and employee contributions);

The general income base is taxed at the appropriate progressive rates. The income from savings is generally taxed at 19% on the first 6,000 euros, with 21% between 6,000.01 EUR and 50,000 EUR, with 23% between 50,000.01 EUR and 200,000 EUR, with 27% over 200,000.00 EUR).

Income generated by life insurance policies, deposits, and financial contracts for the financing of long-term savings plans is exempt from income tax to the extent that the taxpayer does not withdraw any of the resulting capital before the end of a period of 5 years after opening it.

The following are exempt from tax:

- Several types of social and public allowances
- Compulsory severance pay received for dismissal or termination of employment up to the legal maximum of 180,000 EUR. However, the entire amount becomes fully taxable if the taxpayer is newly employed within the next 3 calendar years either by the former employer or by any enterprise associated with a subsidiary relationship with the parent company.
- Compensation for physical or mental injury at the statutory rate or on the basis of a court judgment or insurance contract.
- Income from eligible long-term savings plans.
- Public scholarships awarded for any level of study (including a doctorate) and those awarded by eligible nonprofit organisations regulated by law.
- Scholarships awarded by banking foundations for non-discretionary studies, both in Spain and abroad, at all levels and grades of the education system.
- Child maintenance set by a court.

- Certain prizes and lottery winnings.
- Domestic revenues from maritime and/ or air transport enterprises (as expressly granted under international reciprocity by the Minister of Economy and Finance).
- Income from work (limited to 60,100 EUR per year) earned abroad if it has been effectively taxed in the source country at an income tax rate comparable to that of Spain.
- Amounts received from life insurance.
- Capital gains arising from the transfer of shares or participations in established or newly established companies, provided that certain requirements are met.

The concept of salary covers income from dependent services as follows:

- Salaries and complementary amounts.
- Pensions and unemployment benefit contributions.
- Remuneration of representation expenses.
- Non-exempted family benefits, grants and scholarships.
- Allowances for travel expenses other than those related to transportation and exempted subsistence allowance.
- Any special rights with an economic right reserved by the promoters or founders of a company as remuneration for their services.
- Directors' remuneration obtained by individuals in their capacity as members of a corporate governing body and any amounts related to special contracts (freely negotiated under labour law - i.e. that for a part-time manager).
- Sums received by members of the European and National Parliaments, local councillors and members of provincial government bodies for the performance of their duties.
- Sums received by Spanish Members of the European Parliament and the remuneration of Spanish officials in international organisations, subject to the provisions of the Treaty.
- Remuneration from humanitarian activities or social assistance promoted by non-profit organisations.
- An employer's contribution to their employees' private pension plans or to alternative schemes for employees or their beneficiaries.
- Remuneration from the production of literary, artistic or scientific works as long as the exploitation rights have been assigned to a third party.
- Amounts received for courses, conferences or symposiums.
- Alimony and maintenance payments.

The Spanish social security system is financed by contributions from employers, employees, the self-employed, and the state. All working residents must contribute to this system, which includes a general scheme and special schemes for certain occupational categories. Contributions are calculated on the basis of the monthly salary, excluding certain allowances and benefits, and are limited by minimum and maximum bases, set differently according to occupational category.

Compulsory social security contributions are deductible for personal income tax purposes and are capped.

Netherlands

Income taxation

Married couples are treated as partners for income tax purposes.

The following types of income are exempt from income tax:

- Certain social security benefits;
- Child benefit payments (AKW);
- Inheritances and gifts received;
- Prizes or winnings from games of chance, e.g. lottery (subject to final withholding tax), unless participation in gambling was part of carrying on a business.

In principle, all employment-related benefits are treated as employment income. However, there are some exemptions, such as compensation for emotional injury in the event of dismissal.

A one-off bonus of 2,934 EUR (in 2023) per year to promote re-entry into the labour market and compensation for the costs of voluntary work of up to 190 EUR per month and 1,900 EUR per year (in 2023) are not taxable. Tips may also be exempted up to certain specified amounts.

Employees can deduct the cost of travel from home to work by public transport if the employee commutes at least 4 days a week to the same place. There are distance limits.

If the employee travels 1, 2, or 3 days per week, the deduction is equal to 25%, 50%, or 75% of the listed amounts, respectively, if the distance is less than 90 km. If the distance is more than 90 km and the employee travels 1, 2, or 3 days a week, the deduction is 0.26 EUR per km multiplied by the number of days the employee travelled. The maximum deduction is 2,354 EUR (in 2023).

The employer may instead grant a tax-free allowance of 0.21 EUR per km or the higher actual cost. The maximum number of days per calendar year is 214. If the employee travels less than 128 days in a calendar year, the tax-free compensation is reduced pro rata.

An employer may provide compensation for tax-free employment overhead costs in 2023 as follows:

- Up to a total taxable salary of 400,000 EUR, a tax-free compensation of 3% (1.7% before 2023) of the total taxable salary. This amounts to 12,000 EUR.
- If the total taxable salary exceeds 400,000 EUR, the tax-free compensation of 12,000 EUR is increased by 1.18% of the total salary.

The starting point of the cost reimbursement facility is that reimbursements and provisions made to employees are taxable. In addition, costs that are not designated constitute additional taxable income. The reimbursement facility designates a number of cost items that can be reimbursed without tax. The facility refers in particular to specific exemptions, intermediate costs, and reimbursements (which are valued at zero).

The facility includes the following specific exemptions:

- Business travel costs.
- Temporary residence costs as part of employment.
- Training and education costs.
- Extraterritorial costs under certain conditions.
- Costs of the employer's company products.
- Costs of instruments, computers, mobile communications equipment, and other items (e.g. hardware) that are necessary for business purposes.
- Business relocation costs.
- Outplacement.
- Reimbursements for working from home up to 2.15 EUR (in 2023) per day worked from home. If an employee works from home for at least 128 days per calendar year, this allowance can be calculated as if the employee had worked from home for a maximum of 214 days per calendar year.

In addition, settlements for the following benefits and facilities are assessed to have a zero value (essentially exempt from payroll tax):

- Facilities and benefits that are not used outside the workplace.
- Work clothing that can be worn mainly at the workplace (e.g. uniforms or overalls and clothing with a logo of at least 70 cm^2).
- Food and drink consumed at work but not related to meal.
- Accommodation at work and housing at work, in cases where the employee is not resident at work and the employee cannot reasonably refuse such accommodation.
- Public transport permits or off-peak permits if used for commercial purposes.

Social insurance contribution

The calculation basis for these contributions is the same as for income tax. According to the law which establishes a unitary definition of salary for all types of taxes, the taxable income generated by the use of a company car is included in this base.

For individual taxpayers, state social insurance contributions are integrated into the income tax rate structure. They are calculated annually and included in the first bracket of taxable income, which means that the maximum income subject to these contributions corresponds to the upper limit of the first bracket.

Which countries have introduced/attempted to introduce progressive taxation and what compensatory measures they have adopted?

As shown by the analysis of macroeconomic and fiscal practices over the last 4-5 decades, the introduction of the flat personal income tax is associated with developing or developed economies, but where a gap in living standards persists compared to the most developed countries. Many countries in Central and Eastern Europe adopted the flat rate in the early stages of an economic cycle of accelerated growth, as a prerequisite for stimulating investment and work. The transformation of the countries of the former communist bloc into solid market economies is also partially due to timely tax policies built around the single rate.

Currently, the recommendations of the World Bank, the OECD, and other international organisations converge towards the reintroduction of progressive personal income taxation, in the context of the need for equitable redistribution of wealth. Some of the countries in Romania's region have implemented or are studying the implementation of these recommendations. It is important to note that progressive taxation, which is often present in highly developed economies, as mentioned above, can produce the predominantly positive effects expected if its provisions take into account the economic and fiscal maturity of the countries that adopt it. We present below a brief analysis of the situations of Poland and the Czech Republic, countries which have gradually reverted to progressive taxation.

Poland reintroduced progressive taxation in 2014, after having had a single rate between 2005 and 2014. After 2014, several adjustments were made to tax rates and the income thresholds at which they apply. Currently, the rates are 12% and 32%, with the higher rate applying from an annual gross income level of 120,000 PLN (approx. 27,500 EUR). In compensation, there is a tax deduction of 30,000 PLN (approx. 6,900 EUR) - up to this level of income the tax is zero, while up to the 120,000 PLN threshold, the actual tax rate falls below 10% (due to the allowance). The aim of the authorities was to increase low incomes up to 80,000 PLN per year, protect those with incomes around the 120,000 PLN threshold, and slightly increase the tax rate for those with high incomes (e.g. the real rate, including the allowance, for income of 400,000 PLN per year goes up to 25% and goes up to 30% for income over 800,000 PLN per year).

In the Czech Republic, since 2021, two income tax rates have applied, i.e. 15% and 23%, the latter starting from a threshold equivalent to four times the average annual salary (i.e. approx. 80,000 EUR). Prior to this reform, from 2008 the Czech Republic had a single tax rate of 15%, but the tax base also included the social security contributions due in addition to the gross salary ("super gross salary"). Between 2008 and 2020, taxes on wage income increased, in Czech national currency, by almost 100%, but statistical data (Eurostat) show a steep decrease in these taxes after 2021.

The two countries can be considered as benchmarks for Romania in terms of economic development in the region. Consequently, in order to put things into perspective, and to be able to assess to what extent a transition to progressive taxation would suit Romania in the short term, we need to consider whether the taxation system is mature enough for progressive taxation to work. Some statistical data on VAT collection in the Czech Republic, Poland, and Romania, in relation to GDP and population, are relevant.

	GDP per capita	VAT collected per capita	VAT collected as % of GDP
Czech Republic	€ 26,266	€ 2,084	7.9%
Poland	€ 17,384	€ 1,478	8.5%
Romania	€ 15,013	€ 1,017	6.8%

*Calculations based on EUROSTAT statistical data

The main conclusions of this brief analysis are:

- Romania has been in an excessive deficit procedure since 2019 and reducing the budget deficit is a pressing issue. However, fiscal reform needs to be comprehensive and be carried out on several levels: primarily with a focus on streamlining budget spending and significantly reducing tax evasion, and only then on increasing taxation.

- The appropriateness of introducing progressive taxation should be assessed taking into account the stage of economic development of a country, the point in the economic cycle the country is going through, and the proven capacity of the tax system to collect and implement major tax policy changes.

- Any change in taxation must quantify its effect both on total budget revenues and on the economy. Different categories of budget revenue have different elasticity coefficients.

- Without a profound structural reform of ANAF, the enforcement and control of a progressive system would be very difficult to manage. Well-trained staff and adequate administrative capacity are vital for the smooth functioning of such a system. The effect of progressivity can be achieved through various other measures, e.g. deductions from the tax base with income tax, and tax base caps for social contributions. Tax deductions are needed to protect certain income groups; to minimise the risk of migration of some wages to the grey economy.

- As shown by the analysis of macroeconomic and fiscal practices over the last 4-5 decades, the introduction of a flat tax on personal income is associated with developing or developed economies, but where a gap in living standards persists compared to the most developed countries.

- Progressive income tax systems are highly complex in other European countries, such as Germany, Spain, and the Netherlands. Progressive taxation, which is often found in highly developed economies, can produce the expected predominantly positive effects if its provisions take into account the economic and fiscal maturity of the countries adopting it. In this respect, countries such as Poland and the Czech Republic which have gradually reverted to progressive taxation have also introduced a number of compensatory measures in the form of tax deductions.

- A progressive taxation model leads to an increased administrative burden both for state institutions and for taxpayers. It would run against the existing objective of simplifying the mechanism for calculating, declaring, and paying the tax obligations owed by individuals. Moreover, it would run counter to the objective of creating a simpler tax legal framework, with the aim of increasing voluntary compliance.

- A more complex tax system would increase administrative costs and would certainly require investment in tax infrastructure, staff training, and information campaigns to educate taxpayers.

- An increase in income taxation might lead to higher levels of tax evasion as some taxpayers could look for ways to reduce/minimise their tax liabilities. Consequently the increase might even lead to a reduction in budget revenue, hence undermining the effectiveness of the tax system;

- Romania faces the reputational problem of having a tax system that lacks predictability and stability. This perception is also influenced by frequent changes in tax legislation, lack of clarity and different interpretations, bureaucracy and complicated procedures. Thus, a shift to increased or poorly prepared progressive taxation would only exacerbate this perception.

- Increased taxation could make Romania less attractive for foreign investors and skilled professionals, leading to a possible loss of talent and reduced market competitiveness.

- One of the priorities of fiscal policy, in addition to the distributional effect, should be to support long-term economic growth.

In view of all the above, we consider that increasing tax by introducing progressive taxation to cover the existing deficit would not be a beneficial measure, in a context in which Romania's economy needs investment, which can only be achieved by providing a predictable and stable investment environment. Thus, the FIC supports the maintenance of the single tax rate. Moreover, we believe that any increase in taxation must be balanced with a cap on social contributions, in order to create a fair balance in terms of the tax burden.

Appendix 1

Tax proposals from international institutions

THE WORLD BANK
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A World Bank report proposes the reform of labour income taxation in order to increase fairness, using four reform scenarios to achieve three objectives:

- Broadening the personal income tax base.
- Progressive tax increases.
- Increasing work incentives for low-income workers.

The WB simulations foresee a potential set of four reforms, i.e:

Reform 1 - elimination of IV exemptions; an increase in basic allowances. This increase would be financed solely from personal income tax revenues generated by the elimination of the IT and construction exemptions, which allow an increase in the amount of deductions from 7,200 RON to 10,080 RON.

Reform 2 – elimination of IV exemptions; introduction of EITC; higher single IV tax rate (13%).

Reform 3 - elimination of IV exemptions; introduction of EITC; progressive taxation (6/ 12/ 18%); elimination of deductibility of social security contributions.

Reform 4 - elimination of IV exemptions; elimination of health contributions; progressive taxation (10/ 20/ 25%); elimination of social insurance deductibility.

World Bank report:
https://mfinante.gov.ro/documents/35673/8180698/Raportprivindsistemulfiscal-dinRomania_BM.pdf

Recommendations of the International Monetary Fund (IMF) - income tax reform options for Romania

1. Graduated progressive income tax scale and recommendations to achieve tax neutrality. Introduction of a slightly progressive system on income, with two brackets (16 and 20 percent), with a tax credit for low-income earners (bottom 10 percent).

2. Introduction of a progressive income tax in two bands, with the current 10 percent band to be joined by a 20 percent band applicable only to the top decile of income (top 10 percent). This measure would raise 1 percent of GDP for the budget.

3. Implement a tax credit for the last decile of income.

IMF Report - Romania Reforming Personal Income Taxation, Shafik Hebous, Naomi Feldman, Jean-Francois Wen, Philippe Wingender, June 2022, pages 24-25, accessed at Romania: Technical Assistance Report on Reforming Personal Income Taxation (imf.org)

An OECD 2022 study on Romania's economy concludes that tax revenues in Romania are low by OECD standards as a consequence of tax reforms implemented since 2017 on personal income tax and social security contribution rates that have significantly reduced the tax level. Proposed solutions:

- Improvement of tax collection by modernisiation of tax administration. Development of interconnectivity between the databases of public institutions.
- Introduction of a modern compliance risk management approach to tax recovery administration and fraud detection. Introduction of differential treatment of taxpayers and targeted tax audits based on *data mining*.
- Increasing trust in institutions to increase tax compliance. In Romania, a number of factors, including low enforcement capacity, widespread tax evasion, tax exemptions for large firms, and low spending on public services result in a tax system that is seen as unfair, reducing the willingness to pay taxes.

- Reducing the frequency of tax policy changes and avoiding the allocation of tax exemptions and tax amnesties without proper justification could help restore confidence. Promoting mechanisms, such as credit history, that differentiate and reward responsible behaviour can also encourage compliance.
- Broadening the tax base to raise revenue requires a comprehensive reform of the tax system. Reducing tax expenditures would broaden the tax base and simplify the tax system. A thorough assessment of the distributional and efficiency effects of the tax system needs to be undertaken, as these are not transparent and have been subject to little scrutiny in the past.

OECD 2023 study: https://www.oecd-ilibrary.org/sites/8c99fa4d-en/index.html?itemId=/content/publication/8c99fa4d-en&_csp_=f4d3c57328afb7f1cbd530cb119213be&itemIGO=oecd&itemContentType=book

OECD 2022 study on Romania's economy: https://www.oecd-ilibrary.org/sites/f13f88df-en/index.html?itemId=/content/component/f13f88df-en#section-d1e4471

European Commission

European Commission recommendations - Action Plan on the European Pillar of Social Rights

This recommends a reorientation of taxation away from work towards other sources that are more supportive of employment and in line with climate and environmental objectives while protecting revenues to ensure adequate social protection.

Closer examination of the financing of social protection, and in particular of financing models that maintain continued solidarity between and within generations, while taking into account the possibility of reducing the level of social security contributions and taxes on earned income due to the decline in the working-age population.

Recomandările Comisiei Europene - Planul de acțiune privind Pilonul european al drepturilor sociale https://op.europa.eu/webpub/empl/european-pillar-of-social-rights/ro/index.html

Foreign Investors Council

Is it time to change the taxation of income from wages?