

DETERMINING THE RESULT OF THE EXERCISE OF THE ECONOMIC ENTITIES IN ROMANIA

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***Abstract:** The development of this article started from the need to suitably determine the result of the exercise of the economic entities in our country. The result of the exercise is one of the most important indicators when analyzing an entity that carries out economic activities. In our country, taxation prevails over accounting and, for this reason, it is very important to be able to make a correct interpretation of the result of the activity. In the following we will follow the way in which the expenses and incomes are grouped from the fiscal point of view and how they are taken into account when determining the fiscal result. We will also analyze, in addition to expenses and income, the other elements taken into account in determining the tax result such as: items similar to income, items similar to expenses, tax deductions, and tax loss. For a more complete analysis, we will also treat the deductions from the profit tax due.*

***Keywords:** income, expenses, tax deductions, tax result, profit tax.*

***JEL Classification:** M41.*

1. Introduction

In relation to the fiscal result of the exercise and, implicitly, to the profit tax, we must consider the following items:

- taxable persons and the scope of corporate income tax;
- methodology for calculating the fiscal result;
- determining the due profit tax.

In carrying out the planned approach, it is crucial to treat things in the light of the provisions of the Fiscal Code, represented by Law 227/2015, updated, with subsequent amendments and completions.

2. Taxable persons and the scope of the profit tax

The scope of the profit tax includes the following persons and sources generating the taxable profit:

Taxable persons	The Scope
Romanian legal entities Foreign legal entities with the place of exercising the effective management in Romania Legal entities with headquarters in Romania, established according to the European legislation	Taxable profit obtained from any source, both in Romania and abroad
Foreign legal entities with permanent headquarters/several permanent offices in Romania	Taxable profit attributable to the permanent headquarters/at the level of the permanent headquarters designated to fulfil the fiscal obligations
Foreign legal entities that obtain income from: <ul style="list-style-type: none"> • the transfer of real estate located in Romania or of any rights related to these properties, including the rental or assignment of their use, 	<ul style="list-style-type: none"> • income obtained from the transfer of real estate located in Romania or of any rights related to these properties, including renting or assigning their use

<ul style="list-style-type: none"> • exploitation of natural resources located in Romania, • sale-assignment of the participation titles held 	<ul style="list-style-type: none"> • revenues from the exploitation of natural resources located in Romania • income from the sale-assignment of participation titles held in a Romanian legal entity
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Source: processing from Law 227/2015 - Fiscal Code

Regarding the tax period, as a general rule, it is represented by the fiscal year, which corresponds to the calendar year, unless a taxpayer is established or ceases to exist during a fiscal year. In this case, the taxable period is the period of the calendar year for which the taxpayer existed.

3. The methodology for calculating the fiscal result

When determining the fiscal result, for the purpose of taxation, we follow the relation:

$$\begin{aligned}
 & \pm \text{Accounting result} \\
 & - \text{Non-taxable income} \\
 & + \text{Non-deductible} \\
 & \text{expenses} \\
 & - \text{Tax deductions} \\
 & - \text{Items similar to} \\
 & \text{expenses} \\
 & + \text{Items similar to income} \\
 & - \text{Tax loss} \\
 \hline
 & = \text{Fiscal result}
 \end{aligned}$$

The activities carried out by economic entities are both “producers” and “consumers” of economic resources. These reports concern the result of the entity, for whose determination the terms *income* and *expenses* are used. According to OMFP 1802/2014 for the approval of the Accounting Regulations on individual annual financial statements and consolidated annual financial statements, revenues and expenses are defined as follows:

- **Revenues** are increases in economic benefits recorded during the accounting period, in the form of inflows or increases in assets or reductions in liabilities, which result in increases in equity, other than those resulting from shareholder contributions;
- **Expenses** are decreases in economic benefits recorded during the accounting period in the form of outflows or decreases in the value of assets or increases in liabilities, which result in reductions in equity, other than those resulting from their distribution to shareholders.

By comparing the income obtained with the expenses incurred to obtain them, the result can be profit or loss:

- **Profit**, when the revenues obtained are higher than the expenses incurred;
- **Loss**, when the income obtained is lower than the expenses incurred.

As a result, the equation of the result of the exercise is:

$\text{Accounting result for the exercise} = \text{Revenues for the exercise} - \text{Expenses for the exercise}$

All *income* obtained by an entity falling within the scope of corporate income tax is taxable, except for those that are expressly mentioned in the Tax Code as non-taxable, including:

- dividends received from a Romanian / foreign legal entity paying profit tax / tax similar to profit tax; *
- income from the sale / assignment of participation titles held by a Romanian legal entity / a foreign legal entity; *
- income from the liquidation of a Romanian legal entity / foreign legal entity; *
- the value of new equity securities or the amounts representing the increase in the nominal value of the existing equity securities recorded as a result of the incorporation of the reserves, benefits or issue premiums into legal entities in which equity securities are held:
 - taxable on the date of the free transfer, transfer, withdrawal of share capital or liquidation of the legal entity in which the participation titles are held;
- income from:
 - cancellation of expenses for which no deduction was granted;
 - reduction or cancellation of provisions or adjustments for which no deduction has been granted;
 - recovery of non-deductible expenses;
 - refund or cancellation of interest and/or late payment penalties for which no deduction has been granted;
 - cancellation, recovery, including re-invoicing of expenses for which no deduction was granted;
- income representing increases in value resulting from the revaluation of the fixed assets, land, intangible assets, as the case may be, which compensates the expenses with the previous decreases related to the same asset, etc.
- compensations received based on ECHR decisions;
- incomes registered from a foreign state, in the context of applying the provisions of a Double Taxation Avoidance Convention concluded between Romania and the respective foreign state, and the respective convention provides as a method of avoiding the double taxation the *exemption method*;
- the amounts received as a result of the refund of the share of the contributions of the shareholders/associates, on the occasion of the reduction of the share capital, etc.

* Conditions that must be met by the foreign legal entity from which the income is obtained, in order for them to be non-taxable in our country:

- the foreign legal person is from a state with which Romania has concluded a Convention for the Avoidance of the Double Taxation,
- on the date of registration/sale/assignment, the taxpayer holds, as well, for an uninterrupted period of 1 year at least 10% of the share capital of the legal entity in which he/she holds the participation titles/subject to the liquidation operation.

In order for the dividend income to be non-taxable, the Romanian legal entity that receives the dividends must hold:

- the certificate of attestation of the fiscal residence of the foreign legal person, issued by the competent authority from the state of residence;
- statement on one's own responsibility stating that he/she is a payer of tax/tax similar to the profit tax in the third country;
- documents proving the fulfilment of the condition of holding, for an uninterrupted period of 1 year, at least 10% of the share capital of the legal entity that distributes dividends.

In order to determine the fiscal result, the *expenses* incurred by the entities carrying out the economic activity are divided into three categories: deductible expenses, expenses with limited deductibility and non-deductible expenses when calculating the profit tax.

Deductible expenses are those incurred for the purpose of carrying out the economic activity, including those regulated by the regulations in force, as well as registration fees, dues and contributions due to the chambers of commerce and industry, employers' organizations and trade unions.

Expenses with limited deductibility, when calculating the fiscal result, are represented among others by:

- protocol expenses, which are deductible at a rate of 2% applied to the equation: (Accounting result + Protocol expenses + Income tax expenses + VAT for what exceeds 100 lei in the case of protocol expenses)
- social expenses, which are deductible at a rate of 5% applied to staff salary expenses, provided that they are regulated by a collective labour agreement;
- expenditure on motorized road vehicles which are not used exclusively for the purpose of economic activity, which are deductible at a rate of 50%, provided that these vehicles have a maximum authorized total mass not exceeding 3,500 kg, a maximum of 9 seats, including the driver's seat, and be owned or used by the entity, etc.

The non-deductible expenses, when calculating the fiscal result, are represented among others by:

- income tax expenses;
- expenses related to non-taxable income;
- expenses in favour of shareholders or associates;
- sponsorship expenses;
- expenses incurred without supporting documents;
- expenses with fines, penalties, interest on arrears due to the authorities of the Romanian state or of another state, etc.

Tax deductions represent the amounts that are deducted when calculating the tax result and which are neither taxable income nor deductible expenses recorded in the period for which the calculation is made, being represented, among others, by:

- the legal reserve, which is determined by applying a rate of 5% on gross profit before tax (i.e., accounting result + income tax expense) and which is limited to a maximum of 20% of the value of the share capital;
- deductions for research and development expenses;
- tax depreciation;
- excess costs of the deferred debt.

The Tax Code lists a number of examples representing *income-like elements*, including:

- favourable exchange rate differences, resulting from the valuation of receivables and payables in foreign currency, recorded in the accounting records in the result carried forward, as a result of restatement or transposition, according to the applicable accounting regulations;
- reserves from the revaluation of fixed assets and intangible assets;
- the amounts registered in the credit balance of the account. The result carried forward from specific provisions, representing the reserves that have become taxable, etc.

The Tax Code lists a number of examples of *expenditure-like elements*, including:

- unfavourable exchange rate differences, resulting from the valuation of receivables and payables in foreign currency, recorded in the accounting records in the result carried forward, as a consequence of the restatement or transposition, according to the applicable accounting regulations;
- the unamortized value of the development expenses that was recorded in the carried forward result;
- the loss recorded at the date of the sale of the own participation titles representing the difference between the sale price of the own participation titles and their acquisition/redemption value, etc.

The negative tax result is a tax loss. The uncovered *tax loss* is carried forward and will be recovered from the positive results of the future exercise(s).

For a better understanding of the mechanism for determining the fiscal result we will start from the case study in which S.C. Bruno S.R.L. presents at the end of 2020 the following statement of expenditure and revenue:

- lei

Elements	TDA	TCA
Expenditure, total out of which:	1,067,000	
601 Expenditure on raw materials	230,000	
6022 Fuel expenses	20,000	
605 Energy and water expenditure	30,000	
607 Expenditure on goods	270,000	
613 Expenses with insurance premiums - company building insurance	35,000	
6231 Protocol expenses	8,000	
6232 Advertising and publicity expenses - company	6,000	
624 Expenditure on transport of goods and persons	6,000	
626 Expenditure on postal and telecommunications charges	7,000	
627 Banking services expenses	6,000	
628 Expenses with other services performed by third parties	120,000	
6351 Expenses with other taxes, fees and similar charges (local taxes)	9,000	
641 Expenditure on staff salaries	160,000	
646 Expenditure on employment insurance contribution	4,000	
6581 Compensation, fines and penalties - paid to control bodies	8,000	
6583 Expenses on assigned assets and other capital operations	15,000	
6584 Sponsorship expenses	5,000	
6588 Other operating expenses - without supporting documents	3,000	
6811.1 Operating expenses regarding the depreciation of fixed assets - building	65,000	
6811.2 Operating expenses regarding the depreciation of fixed assets - equipment	25,000	
6811.3 Operating expenses regarding the depreciation of fixed assets - means of transport	15,000	
691 Income tax expenses	20,000	
Revenue, total out of which		1,350,000
701 Revenue from the sale of finished products		360,000

704 Revenue from work performed and services rendered		320,000
707 Revenue from the sale of goods		550,000
7583 Income from the sale of assets and other capital operations		10,000
763 Income from financial fixed assets - dividends		80,000
7812 Income from provisions - other		30,000

The following information is also known:

- In the previous year the company purchased two cash registers in the amount of 1,500 lei each;
- The company owns 2 cars that are partially used for economic purposes and that were used throughout the year;
- It sold a machine with the price of 10,000 lei. The machine had a depreciable carrying amount of 50,000 lei and was tax depreciated until the time of sale for the value of 35,000 lei;
- Dividend income is obtained from a Romanian legal entity, in which it has held 12% of the share capital, for 2 years;
- The company has a share capital of 100,000 lei and a legal reserve constituted, in the amount of 12,000 lei.

We are looking to determine the profit tax due at the end of the year.

Proposed solution:

$FR = AR - NTI + NDE - TD - ISE + RLI - TL$, where:

FR = fiscal result

AR = accounting result

NTI = non-taxable income

NDE = non-tax deductible expenses

TD = tax deductions

ISE = items similar to expenses

RLI = revenue-like items

TL = tax loss

Accounting result: 283,000 lei

$AR = TI - TE$, where:

TI = total income

TE = total expenses

$AR = 1,350,000 - 1,067,000 = 283,000$ lei

Establishing non-taxable income: 110,000 lei

763 Income from financial fixed assets - dividends	80,000
7812 Income from provisions – other	30,000

Establishing non-tax deductible expenses: 156,730 lei

6022 Fuel expenses	10,950
6231 Protocol expenses	1,780
6581 Compensation, fines and penalties - paid to the control bodies	8,000
6584 Sponsorship expenses	5,000
6588 Other operating expenses - without supporting documents	3,000
6811.1 Operating expenses regarding the depreciation of fixed assets - building	80,000
6811.2 Operating expenses regarding the depreciation of fixed assets - equipment	25,000
691 Income tax expenses	20,000

The cost of cash registers is assimilated to the non-deductible expenses	3,000
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Calculation of deductibility of fuel expenses:

When purchasing fuel, it is accounted for as follows:

% = 401 Suppliers	<u>23,800</u>	
6022 Fuel expenses	20,000	
4426 Deductible VAT		3,800

Non-deductible VAT related to fuel expenses: $3,800 \times 50\% = 1,900$ lei
6022 = 4426 1,900

Total expenses regarding the fuel: $20,000 + 1,900 = 21,900$ lei

Determining deductible fuel expenses: $21,900 \times 50\% = 10,950$ lei

Determining non-deductible expenses regarding fuel: 10,950 lei

Calculation of the deductibility of protocol expenses:

$(VT - CT + \text{Income Tax Expenditure} + \text{Protocol Expenses}) \times 2\%$

$(1,350,000 - 1,067,000 + 20,000 + 8,000) \times 2\% = 6,220$ lei

Non-deductible protocol expenses = $8,000 - 6,220 = 1,780$ lei

Tax deductions: 113,000 lei

Fiscal depreciation = 60,000 + 25,000 + 15,000 = 105,000 lei

Deductibility of the depreciation expenses of motorized road vehicles that are not used exclusively for the purpose of economic activity, but which meet the other criteria provided in the Fiscal Code, is limited to a maximum of 1,500 lei / month for each such vehicle.

$2 \text{ vehicles} \times 1,500 \text{ lei / month} \times 12 \text{ months} = 36,000$ lei, from which it results that they are fully deductible.

Legal reserve:

$(VT - CT + \text{Ch IP}) \times 5\% = (1,350,000 - 1,067,000 + 20,000) \times 5\% = 15,150$ lei

$20\% \times \text{CS} = 20\% \times 100,000 = 20,000$ lei

Legal reserve to be established = 20,000 - 12,000 = 8,000 lei

Fiscal result = 283,000 - 110,000 + 156,730 - 113,000 = 216,730 lei

4. Determining the due profit tax

In our country, the profit tax rate, which applies to taxable profit, is 16%, except for entities that carry out activities such as night bars, nightclubs, discos or casinos, including legal entities that make these revenues based on an association agreement, and in the case of which the profit tax due for the mentioned activities is less than 5% of the respective income, and they are obliged to pay the 5% tax applied to these recorded revenues.

Returning to the case study above, we determine the profit tax due:

Profit tax due = 216,730 x 16% = 34,677 lei

From this, the expense with the profit tax, already registered and paid, the possible deductions from the due profit tax is deducted and the final profit tax is obtained.

The following can be deducted from the due profit tax, among others:

- the tax related to the reinvested profit;

- expenses with sponsorships, within the limit of 0.75% of the turnover, but not more than 20% of the profit tax due;
- the cost of electronic diary cash registers, etc.

This, in the case of our case study, means:

Tax deductions from the IP due: 8,000 lei

Sponsorships deductible from the profit tax due: 5,000 lei

$0.75\% \times \text{turnover} = 0.75\% \times 1,230,000 = 9,225 \text{ lei}$

$20\% \times \text{profit on tax due} = 20\% \times 34,677 = 6,935 \text{ lei}$

Expenses with sponsorships made = 5,000 lei, DEDUCTIBLE in full from the profit tax due

The cost of cash registers: 3,000 lei

$2 \times 1,500 = 3,000 \text{ lei}$

Final profit tax = 34,677 - 20,000 - 8,000 = 6,677 lei

Income tax expense, already registered = 20,000 lei

Deductions from the profit tax due = 8,000 lei

5. Conclusions

The calculation of the result and of the profit tax is a series of complex operations that require good knowledge of tax regulations and good professional judgment. Throughout the process, action must be taken with discernment and utmost care, so that the elements of expenditure and revenue are properly framed from a fiscal point of view. The professional accountant must go through and follow the steps and methodology of calculating the profit tax, so that no errors occur that lead to an erroneous tax result.

References:

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