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GMS Flash Alert

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Romania – Ordinance Ushers in Tax and Social Contributions Changes

A recent Ordinance[1] published by Romania's government, applicable from February 2017, makes various changes to the Tax Code, such as:

- altering the method of calculating pension and health contributions due in Romania which, in effect, eliminates specific salary caps;
- exempting investment income from the health contribution;
- bringing in a new deduction for employees; and
- introducing a (non-taxable) threshold for the income tax due on the sale of real estate.

WHY THIS MATTERS

The elimination of the cap on pension and health contributions will significantly increase costs for both employers and employees, including those Romanian inbound and outbound assignees subject to pension and health contributions in Romania. Consequently, companies that have employees who work in Romania or are considering locating staff there will have to take into consideration the (potential) increased cost of social security for those employees, where appropriate, and payroll administrators should make the appropriate adjustments.

However, apart from the elimination of the cap on social security, other provisions of the Ordinance are intended to generate tax reductions for certain individuals. Overall, individuals who are not affected by the elimination of the cap on social security should owe less tax through the combined effect of the new deductions and exemptions.

Highlights of What Has Been Changed by the Ordinance (OUG 3/2017)

Social Security Contributions Due on Salary Income

According to current provisions, the pension and health contributions due by both the employer and employee are capped at five times the average national gross salary per month (currently 5 x RON 2,681 per month). Starting from February 2017, these contributions will no longer be capped. Thus, the pension contribution (10.5 percent for the employee and 15.8 percent for the employer) and the health contribution (5.5 percent for the employee and 5.2 percentfor the employer) will be calculated on total gross income. Although this will represent an increase in costs for employers and employees, the amount of income tax paid will be lowered, because employees are allowed to deduct social security contributions for income tax purposes.

The cap on the health contribution became effective in January 2017. (For prior coverage of the changes to the health contribution, see GMS *Flash Alert* 2015-131, 30 October 2015.) Consequently, the health contribution applied to salary income (both for the employer and employee) will only be capped for January 2017; starting from February 2017, the previous provisions will come back into force.

Health Contribution Due on Income from Investment

Up until 31 December 2016, no health contribution was due on investment income if the individual also had other types of income subject to the health contribution, such as salary income. However, starting from January 2017, the health contribution for investment income became payable, regardless of whether the individual had other income.

Now, according to the new Ordinance, beginning February 2017, the old provisions will come back into force and no health contribution will be payable on investment income if the individual also derives other types of income subject to the health contribution. Therefore, this exemption is not applicable in the month of January 2017, and kicks in again starting in February 2017). With the new Ordinance in force, starting in February 2017, for investment income derived going forward, no health contributions are due if the individual also derives other types of income subject to the health contribution.

KPMG NOTE

Because of the changes under the new Ordinance, January 2017 is the only month for which all individuals deriving investment income and salary income at the same time will have to pay the health contribution on that investment income (starting in February 2017 no health contribution is due on investment income (under certain conditions)).

As this anomaly is likely to require considerable administrative effort both for the tax authorities and the individuals concerned, we will monitor further developments, bearing in mind the possibility that the authorities could alter how this Ordinance is implemented or institute some kind of tax amnesty. However, absent further action on the part of the authorities, all individuals who receive interest, dividends, or capital gains should expect to pay the health contribution on that income for January 2017.

New Deduction for Employees

Until now, medical insurance premiums paid by employees were deductible for the calculation of the employee's taxable salary income, but medical subscriptions were not deductible.[2] From February 2017, medical subscriptions paid by employees will also be deductible for income tax purposes. This deduction is not applicable for the calculation of social security contributions.

Income Tax Due on Sale of Real Estate

From February 2017, a non-taxable threshold of RON 450,000 (approximately EUR 100,000) has been introduced for income obtained from sales of real estate. Any portion of the income which exceeds RON 450,000, will be taxed at 3 percent.

Previously, income from the sale of real estate was taxed with regressive rates of 3 percent or 2 percent based on a threshold of RON 200,000, or 2 percent or 1 percent if the real estate had been owned for more than three years.

<u>Example under Prior Rules</u>

For properties held for less than 3 years:
3% -If the price is lower than 200,000 lei
6,000 lei + 2% applied to the value exceeding 200,000 lei – if the price exceeds 200,000 lei

For properties held for more than 3 years:
2% -If the price is lower than 200,000 lei
4,000 lei + 1% applied to the value exceeding 200,000 lei – if the price exceeds 200.000 lei

[RON 1 = EUR 0.222 | RON 1 = USD 0.237 | RON 1 = GBP 0.189]

KPMG NOTE

The changes made to the Tax Code come after the recent election of a new government and were part of the new government's pre-election campaign pledge on a relaxation of the tax environment in Romania for individuals.

However, these changes may have an adverse effect on high-income individuals, as the elimination of the cap for social security contributions will only affect individuals with gross salaries in excess of five times the average national gross wage. Similarly, individuals deriving real estate income in excess of RON 450,000 (approximately EUR 100,000) may in some cases see the tax on the gain more than double.

FOOTNOTES:

1 *Ordonata de Urgenta nr. 3/2017 din 6 ianuarie 2017 pentru modificarea si completarea Legii nr. 227/2017 privind Codul Fiscal* (Emergency Ordinance no. 3/2017 as of 6 January 2017 for the change and completion of Law no. 227/2015 regarding the Tax Code) was published in *Monitorul Oficial* (Official Journal of Romania) no. 16 of 6 January 2017.

2 These are subscriptions for medical services. For example, the employee pays a monthly / yearly subscription to a private medical services provider and he is entitled to certain standard services covered by the subscription whenever a health issue arises. On the other hand, having medical insurance means that the employee pays a monthly insurance premium to cover against a certain health risk.

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