Government adopts significant changes to the social security and tax system starting January 2018

Executive summary
The Romanian Government recently approved significant amendments to the Romanian tax code. The proposed changes apply from 1 January 2018, subject to parliamentary approval. The impact of these changes is quite profound and organizations with employees based in Romania should take immediate steps to review the new law and design and implement a detailed change program and communication strategy.

The main changes are as follows:
- From 1 January 2018, that part of the social charges currently payable by employers will become the liability of employees, leaving them with the full burden of social charges (pension and health contributions) on salary income.
- The current total social charges rate (employer social charges rate plus employee social charges rate) will be reduced from 39.25% to 37.25%.
- Separately, employers will pay a contribution for work insurance of 2.25% on the remuneration paid to their employees.
- The current income tax flat rate will be reduced from 1 January 2018 – from 16% to 10%.
- The level of social charges due on self-employed income will be reduced.
- Health fund contributions will be due on investment income - dividend income, interest income, capital gain, and other types of income, even when taxpayers are already contributing to the mandatory health fund on salary income.

Key amendments
Currently the social charges due on salary income are split as follows:
- Employee social charges – 16.5%, uncapped. The rate includes pensions, health and unemployment contributions.
- Employer social charges – approximately 22.75%, uncapped (except for the immaterial medical leave contributions). This rate includes pensions, health and unemployment contributions, as well as contributions for medical leave, work related accidents and funds for outstanding salary liabilities.

From 1 January 2018 employees will pay 35% of their gross remuneration as social charges (10% as health fund contributions and 25% as pension contributions). The employers will pay a contribution for work insurance of 2.25% on the remuneration paid to their employees to cover unemployment, medical leave, work related accidents and funds for outstanding salary liabilities. No caps will apply. The social charges due from the employees will continue to be deductible for income tax purposes.

The current income tax rate (applied to salary income, as well as to most other income types earned by individuals – such as self-employment, rental, bank interest and capital gains) will be reduced from 16% to 10%, also as of 1 January 2018.

Starting 1 January 2018, self-employment income is expected to be subject to lower rates of social charges than at present. Currently, self-employment income is subject to health fund contributions (of 5.5%) on the net self-employment income earned, as well as to pension contributions (of 10.5% or 26.3%, as per the individual’s option) on the net self-employment income earned (for pension contributions minimum and
maximum thresholds apply). From 1 January 2018 self-employed individuals will be subject to the health fund and pension contributions (total rate of 35%) computed on a fixed monthly basis (equal to the monthly minimum gross wage in Romania – envisaged to be of RON 1,900, approximately EUR 400, in 2018). In the case of pension contributions the individual may opt for higher contributions.

Currently, health fund contributions are due on certain types of private income only if the taxpayer is not already contributing to the mandatory public health fund for salary, self-employment or pension incomes. Starting 1 January 2018, health fund contribution will be due on these types of income irrespective of whether the taxpayer is contributing to the mandatory public health fund on salary income. The obligation will arise if that other income exceeds the level of a minimum gross monthly wage in Romania. In such cases, the annual health fund contribution will be due on a fixed basis, equal to 12 minimum gross monthly wages in Romania (envisaged to be RON 1,900 per month in 2018 – approximately EUR 400).

Key issues
One of the main issues with the shifting of the employer charges to the employees is that the net salary of the employees will be affected by the increased social charges liabilities (even considering the reduction of the income tax rate). For the employees’ net salary not to be reduced as a consequence of this change, the employer will need to increase the gross salary with the social charges no longer due from the employer. The Government has been exploring legal options to force employers from the private sector to increase the employees’ gross salary with the employer social charges to compensate for employees’ loss in net salary following the expected change. For this purpose, the Government recently introduced a provision under which employers are obliged to undertake negotiations with employees’ representatives to decide on the process for implementing the transfer of employer social charges to employee.

In principle, in the short term, given that the income tax rate will be reduced to 10%, so long as employers increase their employees’ gross salary with the employer social charges, employees’ net salaries should not be affected. Nevertheless, in the long term, some benefits (such as share plans) where the employees are responsible for bearing the employee social charges, the changes should be considered in order to assess the alternatives for mitigating a higher tax burden for the employee and/or inform the employees on the new tax rules.

In the IT and R&D sectors, where employees are exempt from income tax payment, the transfer of social charges will reduce the employees’ net salary, unless employers decide to increase the gross salary to cover such a loss or to share it.

Next steps
Employers should prepare for the expected change by:

- Assessing the financial impact of potential increase of employees’ gross salary, including the impact of such an increase on other remuneration elements.
- Preparing to adjust their payroll and HR software for the necessary changes.
- Preparing for the need of additional resources to address compliance and communication issues (preparing addenda to labor contracts for all employees in a short period of time, communicating to employees the changes and impact on their remuneration package, and so on).