Changes in taxation of traders (3/48/17)

The latest amendments to the Personal Income Tax (PIT) Act and the National Social Insurance (NSI) Act include a set of amendments relating to the tax treatment of traders. These amendments were adopted in the summer and came into force on 8 August. Also, amendments to the Cabinet of Ministers' Regulation No. 899, *Application of Provisions of the Personal Income Tax Ac*t, were approved on 14 November. This article explores some of the changes in the PIT and NSI treatment of traders.

A new approach: PIT payable on at least 20% of income

Currently, a trader's actual business expenses that do not exceed operating revenue can be included in expenses. Any excess should be treated as an operating loss to be offset against operating income in the next three tax periods.

Amendments to the PIT Act provide that when calculating taxable operating income, business expenses that do not exceed 80% of the individual's total operating revenue can be written off as operating expenses. At the same time, certain types of expenses are defined that can be fully included in business expenses without applying the statutory cap.

The taxpayer's operating loss (a negative operating income, ignoring the 80% cap on operating expenses) can be offset in a chronological sequence against taxable operating income in the next three tax years, subject to the 80% cap. The following types of expenses can be fully included in business expenses:

1. Salary and employer's NSI contributions, as well as solidarity tax the trader pays for his employees;
2. Real estate tax;
3. Depreciation; and
4. Compensations to tenants for vacating residential premises and terminating their tenancies because of necessary refurbishment work or rebuilding for the conduct of a trade or business.

An example of how a trader might calculate his tax:

		EUR
1	Revenue	20,000
2	Salaries and employer's NSI	17,796.96
3	Depreciation	1,500
4	Other operating expenses	500
5	Total expenses (5=2+3+4)	19,796.96
6	Profit (6=1–5)	203.04
	Taxable income adjustments:	
7	Depreciation (7=3)	+ 1,500
8	Contractual penalty to related party	+ 200
9	Capital allowances	– 3,000
10	Result of taxable income adjustments (10=7+8+9)	– 1,300
11	20% of operating revenue (11=1x20%)	4,000
12	Operating expenses fully deductible under section 11(3.2) of the PIT Act (12=2+9)	20,796.96

13	Taxable income, allowing for operating expenses fully deductible under section 11(3.2) of the PIT Act (13=1–12)	0 because 20,796.96 > 20,000
14	Tax on operating income (14=13x20%)	0
15	Loss to be carried forward to next periods	1,300

At the same time, necessary changes have been made to the PIT Act and the Cabinet of Ministers' Regulation, because the Corporate Income Tax (CIT) Act will cease to apply from 1 January 2018, and so these rules are included in the relevant sections of the PIT Act. Changes will also be made to the following areas:

1. The employer's contributions to private pension funds are not allowable business expenses if the trader's tax debt exceeds €150 (applicable to traders that use double-entry bookkeeping);
2. The trader's depreciation is governed by the PIT Act, not the CIT Act;
3. When writing off bad debts, individuals will face an extra criterion: 0.2% of net turnover.

The NSI surcharge

Traders currently pay NSI contributions under a scheme applicable to self-employed persons under the National Social Insurance Act. Accordingly, NSI contributions are not payable if the person's monthly income is less than the statutory minimum monthly wage (€380 in 2017). This amount should also be monitored for the year – overstepping the annual threshold of €4,560 will trigger NSI contributions payable at a rate of 31.13% on at least the minimum wage in the month of excess and subsequent months.

This arrangement will continue from 1 January 2018 onwards. The rate of NSI for self-employed persons will increase by one percentage point to be allocated to healthcare services. Additionally, the person should pay contributions for pension insurance equal to 5% of the difference between their actual income and the NSI base, for example:

	Monthly income of €4,000	Monthly income of €300
NSI base (full rate)	380	n/a
NSI base (additional rate)	3,620 (=4,000–380)	300

The additional rate of NSI will not apply if annual income is below €50.

These additional contributions are payable on all income, including amounts received from a foreign taxpayer.