

## TAX MEASURES APPLIED ON THE AGRICULTURAL INCOME IN ROMANIA COMPARED TO THE UNITED KINGDOM

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### *Abstract*

*It is well known that farming has always been risky. The income obtained in agriculture may differ from year to year because of its dependence on the climatic and soil conditions and because of the output prices. Also, the taxation has an influence too on the income, too. Although, both Romania and the United Kingdom are member states of the European Union, the taxation varies, so, the point of this study is to show the differences between the taxes applied on annual income in agriculture in this two countries, attempting to discover recommendations for a better performance, where needed. The conclusions drawn will reveal which agricultural system is more efficient, but also the benefits for the farmers from the both countries.*

*Key words:* agriculture, income tax, tax relief

### INTRODUCTION

Taxes are one of the main instruments of an economic policy. Through a tax system, in some countries, a redistribution of even almost a half of their national income is being made. Ipso facto taxes have significant influence on economy. [8]

Tax systems in the EU countries have been affected by economic, social, and political processes. It should be noted that despite numerous changes those systems have been burdened with defects and still require continuous changes to their adaptation to the new economic conditions. International comparisons regarding taxes may be particularly useful on these conditions. Numerous studies show that the EU countries are characterised by very similar tax systems despite different socio-economic and political determinants. Mendoga and Tesar (2006) indicated that a high share of indirect taxes in the tax system might foster an economic growth. [10]

Taxation does more than raise government revenue. It can affect the behaviour of economic agents in ways that complement or conflict with other public policies, including those directed at agriculture. Exceptions to normal tax regimes can be used as an explicit

policy instrument or may have unintended impacts.

In developing countries taxes on agriculture (particularly agricultural exports) have often provided a major source of public sector funds. Taxation has also been used to stimulate the transfer of resources from agriculture to the rest of the economy. Though there are different ways of taxing agriculture, there is evidence that taxation has reduced agricultural growth. [6]

Yearly income as basis for the taxation in the way we measure it today, is of relative recent date. The taxation of the real income depends on one or another form of record for the enterprise. The alternative and old form of taxation is the cadastral system, i.e. taxation based on a stipulated value of some selected items which in the agriculture sector can be land area, soil quality, the size and composition of the livestock etc. In some countries the tax of small private enterprises is computed as a certain percentage of the annual turnover. Some countries allow averaging the income for a fixed number of years to determine the basis for the income tax. Whereas this method is reserved the agriculture and forestry sectors in some countries it may also be available for all small enterprises. The average method can provide

tax benefits if there are fluctuations in the income from one year to another and the tax system is strongly progressive. [1]

Taxation and administration records where persons that are members of agricultural households can be distinguished from those in other socio-professional groups. Problems with this source are that, in many Member States, some or all farmers are not taxed according to their personal incomes as shown in accounts but by various flat rate systems (per hectare, etc.). Operators of farms arranged as companies may escape coverage (as their directors may not have income from self-employment in agriculture). [7]

## MATERIALS AND METHODS

This study is based on the statistical data from the last three years, provided by Eurostat and tax legislation in effect in Romania and the United Kingdom, but also on the information from various authors. As analysis method, it was used the comparison method. “The comparison method is the most used method in economic and financial analysis. Its main characteristic consists of the study of economic processes and phenomena through a reference criterion, establishing similarities and differences between them.” [4].

## RESULTS AND DISCUSSIONS

The two analyzed countries have agricultural areas in different proportions, but referring to gross value added the situation is inversely proportional to the owned surfaces. Thus, more than a half of the Romania’s territory is represented by rural regions, with extended agricultural areas, compared to the United Kingdom where only a quarter of its surface is represented by it. But, for all that, the gross value added in these states is approximately the same, even though the population and the employment rate in agriculture in Romania are much lower than the U.K.’s ones. (Table 1, Table 2).

In Romania, the income tax in agriculture is due by any farmer who cultivates an area greater than the limits set by law as being exempt from the tax or by any farmer who has

a greater number of livestock than the law limits. [2]

Table 1. Importance of rural areas in Romania

	Territory	Population	Gross Value Added	Employment
	(km <sup>2</sup> )	(persons)	(Million EUR)	(persons)
Year	2013	2014	2012	2014
Predominantly rural regions (PR)	142,545	8,959,110	37,266	3,602,500
Intermediate regions (IR)	94,025	8,705,233	48,260	3,593,000
Predominantly urban regions (PU)	1,821	2,282,968	31,906	1,058,900
<b>TOTAL</b>	<b>238,391</b>	<b>19,947,311</b>	<b>117,432</b>	<b>8,254,400</b>

Source: Eurostat, Economic Accounts for Agriculture[11]

Table 2.Importance of rural areas in the United Kingdom

	Territory	Population	Gross Value Added	Employment
	(km <sup>2</sup> )	(persons)	(Million EUR)	(persons)
Year	2013	2014	2012	2014
Predominantly rural regions (PR)	68,593	1,850,094	34,258	774,700
Intermediate regions (IR)	110,643	14,951,143	360,433	7,004,900
Predominantly urban regions (PU)	69,228	47,507,024	1 396,300	21,743,600
<b>TOTAL</b>	<b>248,464</b>	<b>64,308,261</b>	<b>1,790,991</b>	<b>29,523,200</b>

Source: Eurostat, Economic Accounts for Agriculture [11]

Under U.K. taxation laws, to qualify as a farmer, a taxpayer must satisfy two tests: he or she must be in occupation of land; and the purpose of the occupation must be, at least mainly, for husbandry – i.e. cultivating crops or breeding and rearing livestock. [5]

In Romania, a farmer owes the state an income tax of 16%, but this percent is not applied to the actual income, but to some norms established by law. The income tax will be calculated based on those norms even if the income is grater or smaller. There are

also tax-free limits that varies depending on the crop culture or the livestock.

Table 3. Agricultural income in Romania vs. the United Kingdom

Values at basic prices	2014	2015	2014	2015	2015/14	2015/14	2015/14	2015/14
	Million EUR Romania	Million EUR Romania	Million EUR the U.K.	Million EUR the U.K.	change % Romania	change% the U.K.	Absolute deviation Romania	Absolute deviation the U.K.
Output of the agricultural "industry":	16,771	15,177	31,704	29,169	-9.50%	-8.00%	-1,594	-2,535
Intermediate consumption	9,672	8,773	19,665	18,928	-9.70%	-3.70%	-899	-737
= Gross value added at basic prices	7,099	6,444	12,039	10,241	-9.20%	-14.90%	-655	-1,798
- Consumption of fixed capital	2,812	3,279	3,317	3,414	16.60%	2.90%	467	97
- Taxes	21	21	122	124	0.40%	1.10%	0	2
+ Subsidies	1,839	1,514	3,653	3,485	-17.70%	-4.60%	-325	-168
= Factor income*	6,105	4,658	12,253	10,188	-23.70%	-16.90%	-1,447	-2,065

Source: Eurostat, Economic Accounts for Agriculture

Because the norms of income did not fluctuated significantly in the last three years, the income tax remained at the same level (Table 3). In the United Kingdom, the tax is applied directly to the income, but phased and there is also a relief of £11,000 at the incomes up to £122,000. The income tax is calculated as in Table 4.

Table 4. Income tax rates in the United Kingdom

Band	Income	Tax rate
Personal allowance	£ 11,000*	
Basic rate	£ 11,000 - £ 43,000	20%
Higher rate	£ 43,001 - £ 150,000	40%
Additional rate	Over £ 150,000	45%

\*You do not get a Personal Allowance on taxable income over £122,000.

Source: www.gov.uk [12]

As it can be seen in table 4, the gross value added (GVA) in Romania had a lower decrease (-9.2%) compared to the United Kingdom (-14.9%). In terms of agricultural income, it can be observed (Table 4), that the both countries had a similar variation in the last two years. Thus, in Romania, the income

obtained in 2015 decreased with 23.7% compared to the 2014's income. This fluctuation can be observed at the United Kingdom too, where there was a decrease of 16.9% in 2015 compared to 2014. In spite of that, the relative deviation of 2015 compared to 2014 in Romania had a lower value (-23.7%) than the United Kingdom's one (-16.9%). One of the main causes of this difference is represented by the influence of the subsidies on the income. (Agriculture is the last great subsidised industry. It gets several billion pounds annually from taxpayers through the European Union's common agricultural policy. For investors, it is recession-proof. Regardless of any downturn in the world economy the subsidy cheques keep rolling in. [9]) In terms of tax on income, it can be said that there is the most significant difference between these two states.

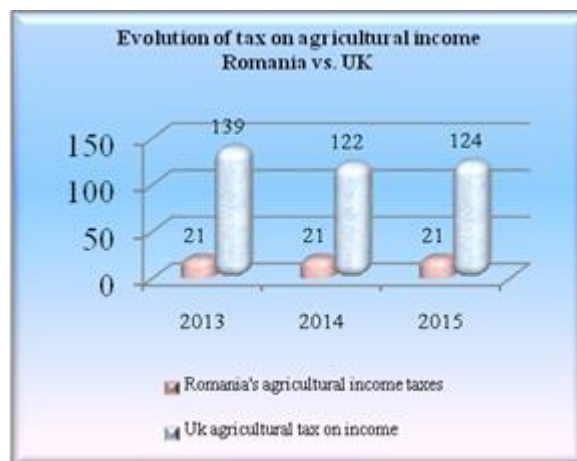


Fig.1. Evolution of tax on agricultural income Romania vs. the U.K.

Source: Own calculation

According to Fig. 1, the tax level in Romania remained almost the same in the last three years, compared to the United Kingdom, which fluctuated. This fact is due to the differences between the taxation systems from the two countries. "A feature of the U.K. is the number of farm businesses arranged as companies, usually with tax minimisation in mind, though these still represent a minority of farms." [9]

To illustrate better these differences it will be presented two calculation models of the income tax, for both states, for two vegetable

farms, where wheat is grown mostly.

Example 1:

(i) A Romanian farmer making a £170,000 profit on a surface of 8,000 ha cultivated with wheat will have the tax-free limit for wheat: 2 hectares, the income norm for wheat: £28.4 (it varies depending on county) and the tax due calculation will be:  $(8,000 \text{ ha} - 2 \text{ ha}) \times (16\% \times £28.4) = 7,998 \times 4.544 = £36,343$  [3]

(ii) A British farmer making a £170,000 profit would lose the personal allowance; the first £43,000 would be taxed at 20%, the next £117,990 at 40% and the remaining £9,010 at 45%. Thus, the calculation would be:  $£43,000 \times 20\% = £8,600$ ;  $£117,990 \times 40\% = £47,196$ ;  $£9,010 \times 45\% = £4,054$ , so, the tax due will be  $= £8,600 + £47,196 + £4,054 = £59,850$ .

Example 2:

(a) A Romanian farmer making a £11,000 profit on a surface of 100 ha cultivated with wheat will have a tax-free limit for wheat for 2 hectares, the income norm for wheat £28,4 (it varies depending on county), thus, the tax due by the farmer will be calculated:  $(100 \text{ ha} - 2 \text{ ha}) \times (16\% \times £28,4) = 98 \times 4,544 = £445,312$

(b) A British farmer making a £11,000 profit would pay 0 tax income because of the personal allowance.

As it can be observed in these two examples, there are advantages and also disadvantages for both taxation systems. Even though the United Kingdom has a more complicated taxation system, the tax-free limit is more significant than the Romania's one, especially for farmers who make profits up to £11,000. So, the Romanian taxation system has advantages compared to the United Kingdom only for large profits.

In terms of tax reliefs, In Romania, in the current financial year, for the income obtained by individuals, if there is a loss due to bad weather conditions (such as: frost, hail, ice, drought and floods) that affects more than 30% of the surface intended for agricultural production, the norm of income will be reduced proportionally with the loss. In the United Kingdom, to mitigate the effects of the profit fluctuations due to bad weather, farmers' averaging was introduced, so that agricultural trades are not pushed into a higher

tax bracket in one year without necessarily having adequate compensation in the following years. This method can be applied for a period of two, three, four or five years. Farmers' averaging is a calculation method, which works as it follows: a farmer A makes profits of: Year 1: £ 40,000; Year 2: £ 10,000; Year 3: £10,000; Year 4: £ 22,000; Year 5: has a loss of £ 12,000. For the year one, year two and year three there will be an averaging of  $(£40,000 + £10,000 + £10,000) / 3 = £ 20,000$ . For years two, three and four, the averaging will be:  $(£ 10,000 + £ 10,000 + £ 22,000) / 3 = £ 14,000$ , and for the years three, four and five, the averaging will be:  $(£ 10,000 + £ 22,000 + £ 0) / 3 = £ 10,667$ . In this way, if the farmer has a loss, he can 'cover' it with the previous profits.

## CONCLUSIONS

The study achieved its purpose, to find the differences between these two E.U. taxation systems.

A first conclusion, based on the 2012 data, is that even if in Romania, on a territory of 142,545 km<sup>2</sup> occupied by rural areas, there are about 3,602,500 persons who are employed, the gross value added (37,266 mil EUR) is almost at the same level as the United Kingdom's one (34,258 mil EUR), which has a surface of 68,593 km<sup>2</sup> represented by rural areas where there are 774,700 employees. This means that the United Kingdom, with a rural area two times smaller than Romania's, can achieve a gross value added at the same level as Romania. This shows the fact that the United Kingdom's agricultural system is more organized, and more focused on helping the farmers, and in the end helping the country.

Thus, a second conclusion is that even if there is an income tax bigger than the one used in Romania, the annual agricultural income in U.K. is greater than Romania's. A cause that led to this situation is represented by subsidies system, which is not a strong point for Romania.

A third conclusion is related to the deviations calculated in this study, so, in Romania, there was an absolute deviation of 62 million EUR in 2014 compared to 2013 and one of -1,447

million EUR in 2015 compared to 2014. In the U.K., there was an absolute deviation of 630 million EUR in 2014 compared to 2013 and one of -2,065 million EUR in 2015 compared to 2014.

A good thing, and also a similarity between the two states is that in both countries there is a tax relief for farmers if their outputs are affected by bad weather.

Finally, is recommended for the Romanian Government to improve the subsidies system, and even the taxation system in agriculture. There should be a more specific method of calculus for the agricultural income tax.

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