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Proposals for Reducing the Administrative Burden of Tax Regulations in Moldova

Ricardo Giucci, Alexander Knuth, Natalia Cotruta, Ana Popa

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German Economic Team Moldova

c/o Berlin Economics

Schillerstr. 59

D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

Fax: +49 30 / 20 61 34 64 9

E-Mail: info@get-moldova.de

<http://www.get-moldova.de>

Proposals for Reducing the Administrative Burden of Tax Regulations in Moldova

Executive Summary

The situation regarding the taxation of business in Moldova is rather contradictory. From a fiscal point of view, revenues from business are extremely low, partly due to a 0% corporate income tax rate, which has been in place since 2008. But the situation is not much better from a business point of view. While the tax burden is practically zero, the administrative burden of the taxation system, which includes regulation of primary documents, tax accounting, reporting and other steps, is very high. Clearly, the business taxation system is highly inefficient and thus in desperate need for reform.

In order to identify the weak points of the tax system in Moldova, we look at each of the 5 steps in the administrative process, which are necessary for business for complying with tax regulations: Fulfilling the requirements concerning primary documents, financial accounting and reporting, tax accounting and the preparation of reports for tax and other authorities, the delivery of reports to the authorities and the activities related to tax inspections. Our research is based on an analysis of current legislation and of relevant data, but also on several interviews with representatives of small and large business. Thus, we do not only focus on legislation, but also on its implementation.

The results of our research are quite straightforward. We have identified severe problems in all 5 steps of the administrative process. Thus, there is lot of work to be done for reforming the whole process. With regard to small business, the most serious problems in terms of the highest administrative costs seem to relate to the first step (primary documentation) and the last step (tax inspections). Thus, any serious attempt to reform the system should also tackle these two steps. Furthermore, it is important to highlight the strong link between these steps. Excessive and highly complicated requirements concerning primary documentation makes it easy for tax inspectors to find mistakes and to demand fines, penalties or other payments from the company. Thus, the high economic cost and the negative image of tax inspections can only be tackled, if also the out-dated regulation of primary documentation is changed.

A further result of our analysis relates to the fiscal function of tax inspections. Representatives from business claim that the severity of tax inspections has clearly increased since the reduction of the corporate income tax rate to 0% in 2008. In their view, fees and penalties partly substituted the payment of taxes, thus contributing to a highly time-consuming and intransparent "taxation" system. Empirical evidence seems to support this claim. In 2008, fines and penalties almost doubled as compared with 2007, and continued to increase sharply in 2009. Clearly, it would be much more efficient to secure state revenues by collecting taxes rather than fines and penalties. Against this background, it would make sense to increase the corporate income tax as soon as possible, thus taking away the revenue raising pressure from tax inspections and facilitating the reform of primary documentation regulation. The discussion above makes clear that single and isolated measures will not help much. What Moldova needs is a systematic approach for reforming its inefficient taxation system of business.

Authors

Dr. Ricardo Giucci	giucci@berlin-economics.com	+49 30 / 20 61 34 64 0
Dr. Alexander Knuth	knuth@berlin-economics.com	+49 30 / 20 61 34 64 0
Natalia Cotruta	natalia.cotruta@gmail.com	
Ana Popa	ana@expert-grup.org	

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1. Introduction

The administrative burden on business in Moldova is very high in comparison to other countries. Major parts of the administrative burden are imposed by the Moldovan tax legislation. Business representatives complain that they spend much time and devote significant resources to activities such as filling out documentation forms, maintaining registers, preparing reports, delivering reports to authorities etc. International studies provide further independent evidence for this view: Moldova has a very low rank (No. 106 of 183) in the "Paying Taxes" category of the World Bank Doing Business Report, although the corporate income tax is 0%, which shows that the lower tax burden can by no means compensate for the excessive administrative burden.¹

This paper aims to derive recommendations for reducing the tax related administrative burden and thus improving the efficiency of the respective administration processes. The following economic impacts are expected to result from the improvement of the administration processes:

- Advantages for business:
 - Lower administrative costs
 - Higher return on investments
 - Improved international competitiveness

- Advantages for public administration:
 - Lower costs of tax collection
 - Lower work burden for public officials (free resources for other activities)
 - Higher tax revenues through facilitated economic growth

The remainder of this paper is organised as follows: Part 2 analyses the complete process of administrative tasks imposed by tax regulations and identifies the areas for improvement with a special focus on the efficiency of the administrative processes. Part 3 derives policy recommendations for reducing the administrative burden and for increasing the efficiency of both business and public authorities. The paper closes with final remarks in Part 4.

¹ World Bank 2010: Doing Business 2011 – Moldova; World Bank/International Finance Corporation/PricewaterhouseCoopers 2010: Paying Taxes 2011. The global picture.

2. Qualitative assessment of administrative burden in Moldova

In this part we analyse the administrative burden of companies for complying with taxation and related state regulations in Moldova. In order to better structure the discussion, we distinguish 5 steps of this administrative process within companies. These steps depict the necessary activities of companies in a chronological manner. Needless to say, in reality these steps might overlap and the strict chronology does not always apply. But for analytical reasons the distinction of these steps makes sense and allows for clearer results.

Step 1: Primary documentation

Each country has its own standards/requirements for documents to be kept by business. If documents do not have the required features, the tax authorities can in the context of tax inspections decide not to accept the documents/invoices, to require the replacement of the old documents through new ones and/or to levy fines.

The Moldovan companies' accounting cycle starts with preparing the primary documents. According to the legal definition, a primary document is the documentary confirmation that an economic transaction has been carried out.

All economic entities, which have to keep accounts, are obliged to use the mandatory forms of primary accounting documents. Mandatory forms of primary accounting documents are templates elaborated by National Bureau of Statistics or by the Tax Inspectorate, and they are printed on special paper with protection signs and serial numbers. Companies have to purchase blanks of mandatory forms of primary accounting documents from the official publishing house "Statistica". Individual document layouts, which differ from the official "Statistica" forms, are not accepted. Examples of mandatory forms of primary accounting documents are: invoices, fiscal invoices, annexes to invoices and fiscal invoices, waybill, receipts, acts of purchasing goods, acts of purchasing rent services and related costs etc.

The documentation of invoices is particularly complicated in Moldova: In order to purchase the templates of fiscal invoices, companies must present a range of documents to the Territorial Tax Inspectorate: a special order form specifying the name of the company and requested number of templates, registers of delivery and procurement for the last two months; inventory register of previously purchased invoices, proxy for the company's employee which will receive fiscal invoices. The Tax Inspectorate needs several days to process the invoice template purchase request, only after approval can the companies get the requested invoice templates.

This shows that much time has to be spent before the actual book-keeping can start. However, it gets even more complicated.

Additionally to the record keeping of primary documents, all information about documents have to be recorded in separate registers. Those registers are book-keeping journals with a specific design according to the Moldovan law. Every primary document has to be registered manually in a specific register (special form No. M13). Pages of this register must be numbered and stitched. Every company has to name an employee responsible for mandatory forms of primary accounting documents. The M13 register has to be maintained in 3 instances: 1 - for the accounting department, 2 - for the employee responsible for primary accounting documents, 3 - for employees actually involved in the economic transactions.

² Exception is the template for fiscal invoices, which is published by the Tax Inspectorate.

Apart from the documents mentioned above, there are even more mandatory forms of primary documents such as expense reports, orders for cash collection, payment orders for cash and payment orders for bank transfers. Those other forms are designed by different authorities and strictly recommended to be used for certain operations.

Companies spend an enormous amount of work and time in order to fulfill all documentation requirements. Document turnover for only one transaction involves up to 14 documents, involving much manual work (for examples see Box 1 and 2).

Box 1:

Comparison of documentation procedures between Moldova and Germany for one transaction: A purchase of goods on account

Moldova: 6 Steps

1. Invoice from seller to buyer
2. Registration of invoice in the Register of Invoices
3. Proxy for the purchaser's employee who will receive and handle the delivery
4. Registration of proxy in the Register of Proxies
5. Waybill for the transportation of the goods from seller to buyer
6. Registration of waybill in the Register of Invoices

Germany: 1 Step

1. Invoice from seller to buyer

Box 2:

Comparison of documentation procedures between Moldova and Germany for one transaction: A small company engages a car driver for a business journey

Moldova: 14 steps

1. Agreement between driver and company.
2. Registration of agreement between driver and company in the "Register of Labor Contracts".
3. Payment order for driver to purchase fuel for cash.
4. Proxy for driver in order to obtain invoice for purchased fuel.
5. Registration of proxy for driver in the "Register of Proxies".
6. Waybill.
7. Registration of waybill in the "Register of Waybills".
8. Invoice and deed of acceptance after services were provided.
9. Registration of invoice in the "Register of Invoices".
10. Expense report by the driver for cash spent for fuel.
11. Cash payment order for driver.
12. Bank payment order for social insurance.
13. Bank payment order for medical insurance.
14. Bank payment order for withhold income tax.

Germany: 2 steps

1. Invoice from driver to company
2. Bank account statement as evidence for invoice clearing

Remark: In this example the driver is treated as a one-day employee, a case which is quite common in the SME sector in Moldova in line with existing regulations.

Considering how complicated the procedures are, it is just natural that mistakes can occur. However, there is no possibility to correct little mistakes in the mandatory forms of primary accounting documents. According to the Accounting Law, any corrections in primary documents for cash and bank operations, delivering/acquisition of goods/services are forbidden. Documents containing mistakes or corrections must be annulled and marked with "Deteriorated" and new complete primary documentation processes must then be carried out. Even in case of minor mistakes or corrections, from the legal point of view such a document is considered as incomplete or inadequate and will be fined with 200 MDL. If same mistakes are made in several documents, fines will be multiplied with the number of documents. In case of using primary documents forms other than established by law, the size of the fine is equivalent to the value of the respective economic transaction.

Conclusion 1: The complicated system of primary documentation causes an excessive administrative burden which goes far beyond international standards. There is serious need for reform.

Step 2: Financial accounting and financial reporting

There are three financial accounting systems in Moldova.

- Simplified system, single entry accounting ("Standard 62")
- Simplified double entry accounting ("Standard 4")
- Classical double entry accounting ("Standard 5")

*The Single entry accounting system*³ is a simplified financial accounting standard. Companies, individual entrepreneurs, advocates and notaries can opt for this system if:

- The activity is based on family members and the number of external employees is less than the number of working family members
- The business meets at least two of the following three criteria:
 - Total sales revenue – not more than MDL 3 m
 - Carrying amount of long term assets – not more than MDL 1 m
 - Average number of staff in reporting period - up to 9 people

Economic agents using the single entry accounting system have to keep all the records in the Register of Receipts (revenue) and Payments (costs and expenditures) and/or in the following registers: Register of Output, Register of Settlements with Debtors and Creditors, Register of Fixed Assets and Low Value Items. These registers are the basis for the preparation of statistical and fiscal reports. The input for these registers is taken from primary documents.⁴

It is valid to calculate the revenue surplus on cash-basis (as opposed to accrual-based calculation method). This is a simplification which helps to reduce administrative burden. However, tax accounting and tax reports are based on the accrual-based calculation only. Therefore, companies need a double entry accounting for taxation reasons, and it is not reasonable to use the simple entry system for financial accounting and a double entry system for tax accounting.

³ National Accounting Standard No. 62 "Single entry accounting" approved by order No. 104 as of 27 November 2002 of Ministry of Finance.

⁴ The list of primary documents is approved by Governmental Decision No. 294 as of 17 March 1998 with the subsequent modifications.

Conclusion 2a: The single entry accounting standard of Moldova is far more complex than international benchmarks of simplified accounting systems. Beyond that, it is not attractive for companies because it is not harmonised with tax accounting regulation. There is serious need for reform.

The Double entry simplified accounting system is described by Accounting Law No. 113 and National Accounting Standard No. 4 according to which the simplified double entry accounting system allows the use of simplified versions of the chart of accounts, simplified forms of accounting registers and financial reports. Companies can opt for that standard if they meet at least two of three following criteria:

- Total sales revenue – not more than MDL 15 m
- Carrying amount of long term assets – not more than MDL 6 m
- Average number of staff in reporting period - up to 49 people.

There is little difference in terms of workload between classical and simplified double entry accounting as the legal requirements are almost identical. On the other hand, the simplified double entry accounting system has further disadvantages such as unclear criteria and it is not accepted by commercial banks for credit assessment.

Conclusion 2b: The simplifications of this standard are only marginal. It is not widely used by business. The objectives of this standard remain unclear. A reform should be considered.

The Classical double entry accounting system is a normal balance sheet accounting as used in most developed countries. However, it is out-dated because this standard has not been updated for the last 15 years.

Conclusion 2c: The classical standard needs some revision in order to comply with international and European standards.

Step 3: Tax accounting and preparing reports for authorities

In the tax law there are no systematic legal rules for tax accounting and accounting records. There isn't a single legal framework for tax reporting as a basis to account for tax payments. In each of the section of the Tax Code there are defined accounting requirements not related to each other, which complicates the work of the businesses.

Although the current CIT rate is 0%, companies must submit a CIT declaration. An incomplete or incorrect CIT declaration is fined by 15% for undeclared or reduced taxable income.⁵

There is a complex system of adjustment from financial accounting data to tax accounting data - 16 differences on the revenue side and 40 differences on the expenditure side. For every row of the CIT declaration an accounting note with explanation must be created. Most of the information in the CIT declaration is related to the accounting of fixed assets.

Beyond that, a wide range of further reports – up to 51 different reports - have to be prepared, too. This creates further workload for business. For most of those reports the addressees and terms of reporting (such as due dates) differ, requiring additional time and costs for report management.

Conclusion 3: There are severe differences between financial and tax accounting, which creates further administrative burdens; a reform should be considered. Furthermore, the preparation of all the reports creates excessive administrative burdens; a reform is urgently needed.

⁵ According to article 260 of the Tax Code.

Step 4: Delivery of reports

Moldovan companies have the obligation to present reports to 4 different authorities:

1. Territorial tax administration direction (TTAD);
2. National bureau of statistics (NBS);
3. Territorial social insurance house (TSIH);
4. Territorial medical insurance house (TMIH).

Every type of report must be created in 2 exemplars, one is kept by the authority and another with the authority's stamp is kept in the company's accounting department.

All reports must be presented personally by the company's representatives. That means that the representative has to visit the respective authority personally and must meet his dedicated official in charge. Due to the obligation of personal presenting of reports, economic agents are forced to spend their work time for staying in queues in front of authorities' doors in order to fulfill the report presenting procedure. For an average SME's accountant it takes approximately 1 day per month, which means more than 100 of working hours per year. For authorities it involves additional staff and resources. Such a system of reporting is time consuming and costly.

Theoretically, the possibility to present reports via post mail should solve the problem. But practically only some types of reports are accepted by post.

In 2009 started the project "electronic declaration"⁶ which allows companies to present income tax reports via internet without the need to spend time for personal visits and "queuing". Despite obvious advantages of the project (electronic signature, time saving and additional services), it did not become popular among business. In 2010 only 108 companies have become registered users of this service and till present only 136 have presented electronic declarations. One of the reasons of limited success is the quite high price for using the service (almost MDL 3,000 per year).⁷

Starting from 21 February 2011, the diversification of possibilities and decreasing of prices for electronic declaration services was announced. The service will become available for individual entrepreneurs as well.

However, the requirements of personal visits for presenting other types of reports (statistical, financial, social and medical insurance) remain.

Conclusion 4: The report delivery process needs to be reformed, with the aim of saving valuable working time for companies.

Step 5: Tax inspections

All private sector representatives we have interviewed during our research stated that tax inspections are a key area of concern and must be seen in connection with the primary documentation regulation (Step 1). Tax inspections search feverishly for mistakes in the documentation and penalise even minor mistakes. There is overwhelming agreement in the impression that the complicated primary documentation requirements force business into traps of making documentation mistakes; business which are trapped and fined are a welcomed source of additional income for tax authorities.

Tax regulation experts provided more evidence by explaining that many provisions of the tax regulation are contradictory and that it is partly impossible to comply with the requirements.

⁶ Main State Tax Inspectorate project with support of USAID/BIZTAR, see www.servicii.fisc.md.

⁷ This is the number of Electronic Declaration users; in regards to Declaratia Rapida (Bar code processing, developed also with USAID|BIZTAR assistance) - there are 9111 users as of 01 January 2011.

Primary document regulation and tax inspections have become even more strict since 2008, at the same time when the corporate tax rate was cut to 0%. From our analysis we come to the conclusion that this is no coincidence: Tax inspections in Moldova have the function to raise revenues that compensate partly for the loss of corporate income tax revenue (Box 3 provides some anecdotic evidence).

Box 3

Example for "fine hunting"

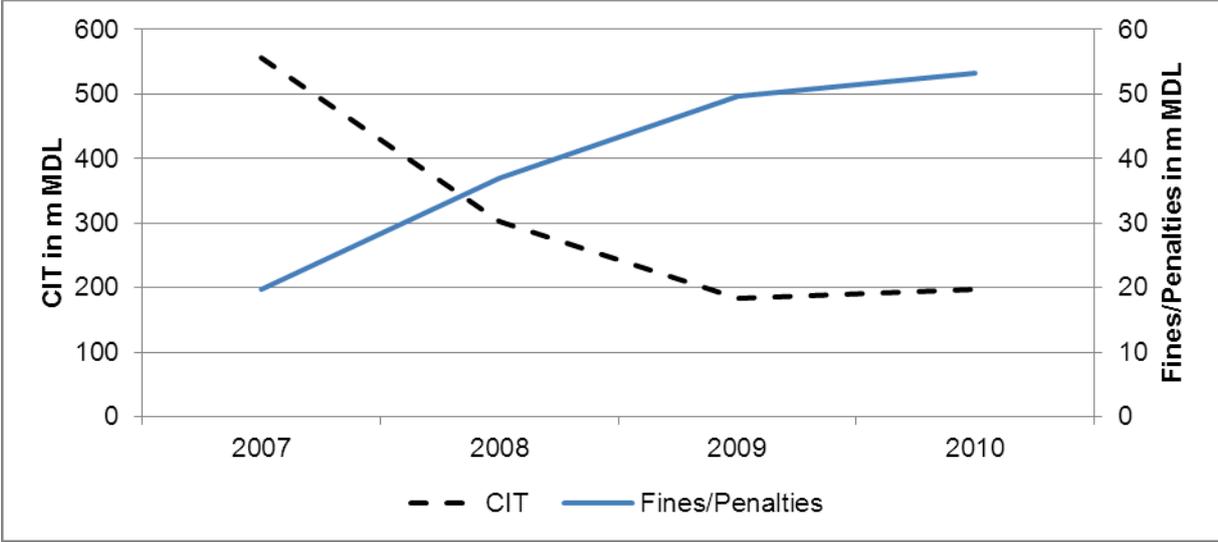
In 2008⁸ the regulation regarding primary documentation was changed and became more strict. One of the new rules was the obligation to fill the invoice templates with dash signs ("-") in all cells that do not contain any data. One year later⁹, this specific rule was abolished.

Between these two dates many companies have been penalised for every document which did not contain all those dash signs. It seems that the only objective of this specific regulation was the collection of fines.

Further evidence for the connection between Step 1 and Step 5 can be drawn from analysing state budget revenues: At the same time when revenues from corporate income tax have decreased the amount of revenues from penalties and fines raised by tax authorities more than doubled (see chart 1).

Chart 1

State budget revenues from corporate income tax (CIT) and fines/penalties¹⁰



Conclusion 5: Tax inspections currently cause an excessive burden on business. It is very inefficient from both economic and political perspectives. There is an immediate need for change.

⁸ Governmental Decision No. 1185 as of 20 October 2008.
⁹ Governmental Decision No. 434 as of 15 July 2009.
¹⁰ Report on execution of state budget for 2007 (Ministry of Finance) published in Monitorul Oficial Oo. 145-151 as of 08 August 2008; Report on execution of state budget for 2008 (Ministry of Finance) published in Monitorul Oficial No. 172-178 as of 21 September 2009; Report on execution of state budget for 2009 (Ministry of Finance) published in Monitorul Oficial No.182-189 as of 28 August 2010; data for 2010 from the Ministry of Finance.

3. Proposals for reducing the administrative burden

Recommendation 1:

- Radical simplification of primary documentation regulations (link to Step 1)
- Release the burden of tax inspections (link to Step 5)

Explanation:

It is clear that the combination of tax regulations and tax inspections must form a safe system, which precludes systematic fraud from business side, but it must meet the criterion of efficiency, too. The current Moldovan system of primary documentation is very inefficient because it is very complicated and time consuming, creating excessive burdens for both business and public administration.

International experiences show that documentation requirements can be simplified without increasing the danger of fraud and misuse. By contrast, the administrative burden of Moldovan primary documentation regulation has increased even more recently.

At the same time the burden of tax inspections have increased continuously in Moldova. We recommend limiting the role of tax inspections to their primary function: The prevention of tax evasion and tax fraud. In order to fulfil this function, tax inspections must prosecute infringements of tax regulation. However, minor mistakes, that are obviously a result of inadvertence and do not harm anybody, should not be punished.

As we have shown in our analysis, there are strong linkages between the steps of the taxation process, in particular between the steps 1 and 5. Trying to reform only parts of this process is not conducive to positive results. The implementation of the simplification of documentation requirements (Step 1) is not likely to succeed as long as penalties (Step 5) have a revenue raising function. If primary documentation becomes more simple, companies will make fewer mistakes, which in turn means that tax authorities collect less revenues from fines and penalties.

We, therefore, recommend a package of two reform measures simultaneously.

When the tax inspections stop penalising minor documentation mistakes, a loss in public revenues might occur, which must be compensated somehow. In order to do so we recommend considering an increase in the corporate income tax rate. Clearly, the discussion about the appropriate level of corporate income tax involves several more aspects which cannot be discussed here; but our analysis concludes that the business side prefers a moderate but transparent tax burden to an excessive administrative burden.

Recommendation 2:

- Improve simplified accounting standards (link to Step 2)

Explanation:

Simplified accounting schemes are effective and efficient measures for reducing administrative burden on business, especially with respect to the objective of facilitating the development of small and medium enterprises. However, this implies that the reports resulting from the simplified financial accounting system can be used for tax purposes, too.

Germany has, for instance, made good experience with the simplification of accounting requirements for individual entrepreneurs and small enterprises. Most important: In Germany the simplified regulation for financial accounting and reporting are identical to simplified tax accounting and reporting regulations. As an example: Accounting on a cash

basis is a valid option for financial accounting and so it is for tax accounting (as opposed to Moldovan regulation, see chapter 2.3)

We recommend considering an enhancement of the accounting simplifications in Moldova, but only if simplified financial reports and tax reports get harmonised or - even better - unified (see also recommendation 3).

Recommendation 3:

- Harmonisation and unification of reporting requirements (link to Step 3)

Explanation:

The financial reports produced by the financial accounting system should be the sole base for all kinds of reporting. Differences should be reduced to a minimum. This is particularly the case for corporate income taxation reports.

Furthermore, we recommend reducing the total number of reports. This includes reports for other taxes such as local taxes, reports for social security, reports for medical insurances and statistical reports.

The number of reports can be reduced by further harmonisation and unification of reporting regulation. To state it clearly: We do not favour single tax approaches, because single tax models entail further risks, such as unintentional side effects. However, we argue in favour of single reports so that most tax and/or social contribution liabilities can be derived from a single report, which is - in the best case - harmonised with the financial report.

The harmonisation and unification of reporting regulation includes the harmonisation of terms of reporting, mainly the due dates. Such a harmonisation is fast and easy to implement and has a big positive impact on business as it reduces the administrative burden significantly.

Recommendation 4:

- Simplification of the requirements for the delivery of the reports (link to Step 4)

Explanation:

The time companies spend on physically presenting reports at the respective authorities is a waste of economic resources. It should be valid to deliver reports via mail (post office). This method is internationally widely accepted and would be appropriate for Moldova as well.

Electronic file transfer of reports could be an option as well. It must be considered that many entrepreneurs in Moldova do not possess a computer, but for those who are equipped with computers, an electronic reporting system could be a way to improve the administrative efficiency. Such an e-government tool is already in place in Moldova, but the price model for using the system should be appropriate to Moldovan conditions.¹¹

¹¹ USAID|BIZTAR has already started to work on the development of the electronic reporting system for three state authorities: Tax Inspectorate, National Insurance House and NBS.

4. Final remarks

Business taxation is a key determinant of the business climate. However, business taxation does not only include the tax burden, but also the administrative burden related to the taxation system. In the case of Moldova these two aspects differ completely. While the tax burden is practically zero, the administrative burden is huge.

This state of affairs is far from optimal. Businesses can cope with a certain degree of tax burden, as long as it is predictable and transparent. Besides, the correspondent public revenues enable the state to secure a higher level of public goods such as infrastructure, education and justice; all goods from which businesses benefit greatly and which are rather scarce in Moldova. Thus, a reasonable tax burden involves per se no efficiency loss, but just a distribution from the private to the public sector. The correspondent assessment of the administrative burden is completely different. A high administrative burden amounts to a waste of resources in terms of time and money not only for the private, but also for the public sector. Here we are talking about a clear loss of efficiency and productivity, which is without doubt partly responsible for the low level of income and wages in Moldova.

Thus, the country needs to reverse this condition. First, the administrative burden has to be drastically reduced. Technically speaking this is not very difficult, as we show in this paper. But also politically there should not be major resistance for reducing "bureaucracy". On the contrary, the reduction of the administrative burden for business, and especially for small business, will be highly popular with voters. Second, we see room for increasing the tax burden. Such a measure would indirectly be also important for reducing the administrative burden. As shown in the paper, there is a negative relationship between both factors: The reduction of the tax burden in 2008 (i.e. the setting of the corporate income tax rate at 0%) has immediately led to an increase in the administrative burden. Following this logic, a higher CIT rate would facilitate the reduction of the administrative burden in the near future from a fiscal point of view.

To sum up, a switch from a system that is predominantly based on creating administrative burden towards a more efficient taxation of business would be in the interest of business, the state and thus of the whole country. In short, this would be a clear win-win-situation for all stakeholders.

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