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PAYROLL TAXATION: A SOURCE OF REVENUE FOR THE STATE AND/OR A BURDEN FOR EMPLOYEES AND EMPLOYERS

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Abstract: *An important part of the government revenue needed to cover state expenditures comes from tax revenues from labor taxation. Revenues obtained by taxing the income of employed individuals, consisting of income tax and compulsory social contributions, contribute to strengthening the sustainability of public finances and play a significant role in redistributing economic growth across different segments of the population and creating equitable societies. A high tax burden can have negative effects on employment and labor market competition. The paper assesses the level of labor taxation in Romania and in some neighboring countries that apply a personal income tax regime similar to that of Romania (Bulgaria, Hungary) and in some countries in the region economically close to Romania, but with a different labor tax regime (Czech Republic, Poland).The tax burden on labor is analyzed using statutory personal income tax rates and social insurance contribution rates paid by employees and employers. For a better picture of the attainment of the objectives pursued through taxation, the share of labor tax revenues in total tax revenues and in GDP is highlighted.*

Keywords: tax revenues, tax burden, personal income tax, social security contributions

1. Introduction

The new challenges faced by societies, which overlap with economic globalization (notably population aging, migration, severe climate change, technological dynamics and digitalization, as well as ideological and generational divisions and polarization), place states in front of questions that require joint efforts and response actions, largely supported through the mobilization of public financial resources. At the same time, general public needs, which have become much more numerous and diverse along with economic and social development, put pressure on public budgets as they require the allocation of significantly higher volumes of public financial resources to be met. As a result, in the context of limited resources and multiple, costly needs, the fulfillment of the legally assigned roles of public institutions, as well as those expected by society, depends both on the volume of public financial resources available to the state and on that of financial resources attracted from non-public sources.

Romania, faced with a major funding deficit, a precarious economic context, and numerous external uncertainties, is compelled to take action to create an efficient tax system that ensures the sustainability of public finances and responds to the specific characteristics of the current economic climate. At the same time, the state's specialized institutions are intensifying their efforts to increase the collection rate of budget revenues and thus fulfill the commitment made through the

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National Recovery and Resilience Plan (NRRP) to raise the share of revenues in GDP by 2.5 percentage points by the fourth quarter of 2025 compared to 2019 [1]. Measures aimed at increasing voluntary compliance and reducing tax evasion, whose impact is reflected in the volume of tax revenues—much lower compared to that of other countries—are also aligned with this goal.

It is well known that through taxation, the state secures significant financial resources at its disposal, which are subsequently redistributed to institutions that provide public goods or services, or to other areas that generate economic and social value. Structurally, the tax revenues collected by Romania that have a direct impact on the labor force are largely composed of income taxes and social security contributions.

Starting from the hypothesis that, in an initial phase, labor taxation affects the incomes of employees and employers, and subsequently impacts the attractiveness and competitiveness of the labor market, this article examines the impact of wage taxation and social security contributions on individual taxpayers. It also analyzes the role each of these two fiscal indicators plays in forming public financial resources.

2. Normative Landmarks Regarding Salary Tax Obligations and Their Roles

Regardless of the time period considered or the sector in question, topics related to salaries and their associated tax obligations resonate deeply with both employers and employees. Typically, the taxation of income generates a certain level of discomfort (or even rejection) among taxpayers who see their earnings diminished as a result. The clearest example in this regard is the income tax on wages, which, due to its direct implementation, is strongly felt by every employee/taxpayer. This dissatisfaction is even more pronounced when those required to pay do not see their efforts reflected in the quality of services or social infrastructure provided by the state.

The broad scope of wage taxation, along with the practical differences in its determination and levels, can be observed in the definition provided by the OECD: “a tax paid by employers, employees, or self-employed individuals, either as a proportion of wages or as a fixed amount per person, and which does not entitle the payer to social benefits” [2]. Each state’s independence in choosing its tax regime has a significant impact both on the revenue collected by the state and on the income that remains with the taxpayer.

As a member state of the European Union, Romania imposes taxes on individual incomes in accordance with its own fiscal legislation (Law no. 227/2015 regarding the Fiscal Code), which is harmonized with European legislation in the field. With the definition of taxable income and the corresponding fiscal obligations, the Romanian legislator sets the tax regime, the level, and the method of calculation for each tax withholding.

At the same time, it differentiates between types of fiscal obligations by the fact that, unlike the obligation to pay income tax, for which no reference is made to its intended purpose or any subsequent benefit, when it stipulates the obligation to pay social contributions it specifies both the purpose “to protect individuals by requiring insurance against certain social risks” and the benefits “in exchange for which these individuals benefit from the rights covered by the respective contribution” [3].

According to the provisions of Romania’s Fiscal Code, the category of salary income includes “all income, in cash and/or in kind, obtained by a resident or non-resident individual who carries out an activity based on an individual employment contract, ... regardless of the period to which it refers, the name of the income, or the form in which it is granted,...” [4].

Thus, the aforementioned legal act requires individuals who receive income from salaries

or income assimilated to salaries “to pay a final monthly tax, calculated and withheld at source by the income payers,...” [5].
To determine the tax obligation on salary income, a flat tax rate of 10% is applied to the taxable base, which is established after deducting amounts owed as social security contributions and those qualifying for exemptions provided by law.
The social contributions paid by the employee are correlated with the rights granted, which are detailed further based on the risks covered by each type of contribution paid, namely: the social insurance contribution (with a rate of 25% of the gross income from salaries and income assimilated to salaries) and the health insurance contribution, with a rate of 10% of the gross income from salaries and income assimilated to salaries (Fiscal Code, Art. 156). Additionally, employers are required to pay the social insurance contribution, depending on the working conditions of the employee (4% for special working conditions and 8% for hazardous working conditions), as well as the labor insurance contribution (2.25% of the gross income from salaries and income assimilated to salaries).
From the above, it can be observed that under the established legal provisions, the state collects a portion of the income earned by various individuals and/or legal entities that fall under the designated taxpayer categories, without assuming any direct obligation toward them.
Since the salary, together with the social contributions borne by the employer, are components of labor costs, any change to one of these elements affects both parties of the employment contract: the employee-the salary beneficiary, and the employer—the payer. Therefore, both parties have an interest in keeping the level of taxation as low as possible, so that the employee retains an income that brings satisfaction for their work and ensures a higher level of well-being, while the employer maintains personnel expenses at a level that does not compromise their resilience in the labor market and competitiveness.

3. Analysis of the Impact of the Labour Taxation System on the Level of Budgetary Revenues

In order to highlight the way in which the personal income tax regime reflects on the tax revenues collected by the state, we investigated a comparative analysis of the share of labor tax revenues (structural component of tax revenues) obtained by Romania and four other European countries in total budget revenues and in GDP, according to the particularities identified for each country. In order to achieve the intended goal, the analysis included two neighboring countries that apply the same payroll taxation regime as Romania, based on the single rate (*Bulgaria, Hungary*), and two other countries that are close to Romania in terms of territory and/or have similarities with Romania, both in terms of economic and geopolitical challenges (*Poland, Czech Republic*).
The period covered by the analysis captures, on the one hand, the effects of the political factor, through the fiscal-budgetary policies promoted by the ruling parties in power or coming to power following the elections (which took place during the chosen period) and, on the other hand, the overlapping effects generated by the Covid 19 pandemic and by the invasion of Ukraine by Russia (February 2022).
The documentation and elaboration of the paper is based on the results of studies conducted by national institutions/organizations (Fiscal Council, 2022; Ministry of Finance; National Trade Union Block, 2025; Bucharest University of Economic Studies, 2024 etc.) and international (OECD 2024, 2025; EC, 2024; World Bank, 2023; IMF, 2023, 2013; Molinari Economic Institute, 2024; Forvis Mazars, 2024), as well as those highlighted in the elaborations of Romanian authors (N. Mihăilă, 2023; Ciobanu & Sahlian &Vuță, 2020 and others) or foreign (Albertini &

Poirier& Terriau, 2025; Ban &Rusu 2029; Torres 2012).

As argued above, tax revenues are the basis of the budgetary resources used by the state, consisting of all taxes, duties and social contributions collected by the state at a given time, in accordance with the legal regulations in force. According to their nature, according to the economic criterion, tax revenues are based on three main categories of revenue, namely: revenues from labor taxation, revenues from capital taxes and revenues from consumption taxes. A high level of these revenues can help the state finance high-quality public services (such as education, research, infrastructure, healthcare), without which a state cannot prosper.

In order to determine their contribution to the realization of state budget revenues, the revenue level indicator is used, consisting of the share of total revenues from taxes and social contributions in GDP (Fig.1) and then highlights the share of each main tax category in the structure of tax revenues in the total tax revenue (Figure 2).The main source of data is the European Commission's database which centralizes Member States' tax revenues and the Annual Reports published by the Commission.

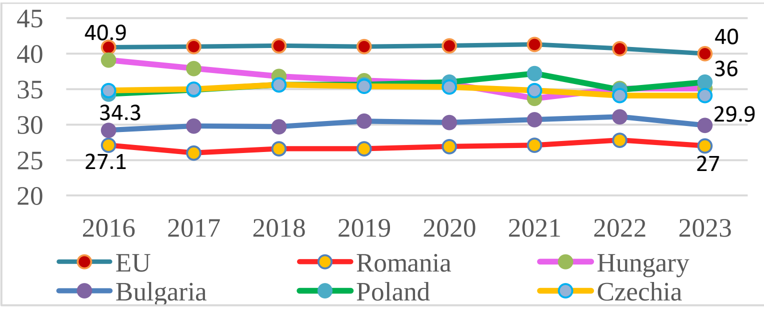

Figure 1: Revenue from taxes and social contributions as a share of GDP
Source: European Commission, Annual Report on Taxation 2024,
Eurostat (gov_10a_taxag), Author processing

Your manuscript must fit within the required The data captured in Figure 1 shows not only that Romania achieved the lowest level of tax revenues (as a percentage of GDP) compared to the EU average and the other countries in the analysis, but also that these revenues are on a downward slope, without reaching even 28% of GDP in any of the years of the period analyzed. It can be observed that in 2023, the revenue level drops to 27%, below the figure 2016 (27.1%) and in 2022, when their level reached 27.8% all other countries except Bulgaria exceeded 30% of GDP in fiscal revenues.

Without making any specific remarks on one cause or another, but considering that they are the result of an accumulation of fiscal-budgetary decisions and a low degree of collection, we bring to your attention some of the observations of the specialists of the Fiscal Council, which highlight some of the more important observations. It is thus recalled that "*a tax revenue generated by a tax is the result of the product between the tax base and the tax rate(s)*", but also that "*the tax base can be reduced, mainly by two methods: (a) exemptions, reductions or alternatives granted by the legislator, and (b) evasion;...*" [6].

Since a higher tax-to-GDP ratio does not necessarily mean that the amount of tax revenues has increased in nominal or even real terms, the structure of these tax revenues should also analyzed for relevance. Thus, the total amount of tax revenue collected is the result of the contribution made by each of the category composing tax revenues (also considered by the European Commission), namely "Taxes on production and imports"; "Taxes on income and wealth" and "Social contributions", as reflected below (Figure 2).

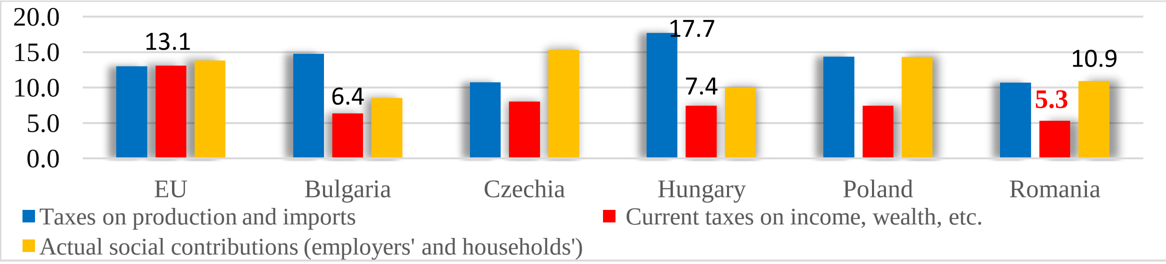

Figure 2: Level of the main tax categories in total tax revenues in 2023 (% of total), Source: Eurostat, Author processing

According to the data reflected in Figure 2, Romania has the lowest volume of resources collected from income taxes (19.7%) and the highest share from social contributions, which, as shown below, are predominantly borne by employees which leads to an increased tax burden on employees. Taxes on labor account for more than half of EU tax revenues (67%), as in all but two other countries in the analysis, Hungary and Bulgaria. In contrast to Romania, these two countries have a close distribution between revenues from the two categories of taxes that constitute the tax burden on labor: income tax and social security contributions.

The Czech Republic which has a progressive labor tax regime, has a level of income from social security contributions similar to Romania. However, in terms of social security contributions, the employer's obligations are higher than those paid by the employee, both in terms of social security contributions (24.8% employer and 7.1% employee) and health insurance contributions (9% employer and 4.5% employee) [7].

The reactions of international institutions to this reality are unanimous, each of them drawing attention to some of the factors that determine the low volume of tax revenues collected by Romania and suggesting various solutions to increase them. For example, the World Bank shows that Romania has the second lowest total tax revenue as a percentage of GDP in the EU and "obtains very little tax revenue from personal income tax compared to other European countries" [8], and, compared to other countries, relies more on social contribution revenues. Among the determining factors identified by the institution are the reduced flat-rate tax rate on income earned by employees and the various exemptions that narrow the tax base.

In the press release following their visit to Romania on February 1, 2024, IMF officials argued that "*Romania's tax revenues are well below the level of similar countries and too low to sustain public services at EU standards*" and concluded that "*there is no realistic way forward without substantial fiscal policy reform*" [9]. Among the measures proposed by the institution is a move to a progressive tax system of income tax.

The findings are also reinforced by the OECD, which, in its economic study on Romania in 2024, notes that the country's low fiscal revenues stem from a narrow tax base, further undermined by evasion [10].

4. Characteristics and Possible Effects of Labor Taxation Systems

4.1. The Pros and Cons of Current Labor Taxation Practices

As a starting point in the analysis of the tax burden on earned income, it should be noted that each country has its own rules for taxing labor, applied according to their adopted tax system: flat tax system/flat rate (*flat tax*) or tax system with progressive rates. The differences between the two systems are significant. Thus, the flat-rate system implies a proportional taxation of taxable income, meaning that regardless of the size of the income, the same tax rate is maintained. Under the progressive personal income tax system, the tax rate increases as the taxable amount of income/tax base increases. There is evidence that flat tax rates are applied by some ex-communist countries "which use taxation as a comparative advantage to stimulate work and investment," and "progressive tax systems are mainly found in developed countries, where an optimal distribution of income is desired" [11].

Academic literature notes significant differences not only between the labor tax systems applied by states but also between the tax levels of countries with the same system, as seen among the five compared states. Bulgaria, Hungary and Romania apply flat-rate labor taxation, while Poland and the Czech Republic rely on progressive taxation, with each system having both supporters and detractors (with flat tax support declining).

Critics of the flat tax argue that it is regressive, thus fiscally and socially inefficient, especially for low-income individuals [12]. The idea is also supported by Romania's Tax Council, which points out that "through numerous derogations from this type of taxation, some taxpayers end up being taxed regressively, while other taxpayers are taxed proportionally, which erodes the spirit of fairness and solidarity in society" [13].

The low flat rate is often accompanied by higher social security contribution rates (as exemplified by Romania: 10% income tax, 25% social insurance, 10% health insurance). Ultimately, employees taxed at a flat rate may bear a higher real fiscal burden than those under progressive systems. For example, in 2023, real tax rates in flat-tax countries increased by 0.12%, while in progressive systems they decreased by 0.07%. [14].

Although support for the flat tax has waned, certain literature presents arguments in favor of its introduction/maintenance, such as "increasing budget revenues via the 'Laffer effect,' whereby lower taxes encourage major taxpayers to avoid the underground economy, thus broadening the tax base." [15]. A similar opinion is held by Gabriel Biriș, who in an interview given in 2024 with reference to Romania, shows that this type of taxation "does not discourage work; encourages voluntary compliance; simple system to understand and administer; and has brought more money to the budget than progressive rates, ..." [16].

As arguments against a progressive system of income taxation, the negative effects on economic growth and labor force participation in economic activity are cited, including the encouragement of tax evasion [17]. The arguments for progressive income taxation have become more numerous as more and more countries face budget deficits. The main arguments put forward by supporters of the system are that it "plays an important role in achieving a more equal distribution of after-tax income than before" [18]. Based on the findings that Romania's single-rate tax system has very low progressivity and affects the incentives for labor supply through the system and transfers, both the World Bank and the IMF recommend that Romania introduce a progressive income tax system.

4.2. Dimensions of the Fiscal Burden on Labor. Differentiations between Countries

Based on the fact that tax and social security systems differ from country to country, it is difficult to conduct a comprehensive comparison of countries' tax systems. However, in line with industry practice, the structure of several indicators has been agreed. On the one hand, these indicators can be used to shed light on the employment/jobs costs borne by employees and, on the other hand, what share of the total is borne by the state in various forms.

In accordance with the objectives considered, the following highlights the fiscal burden on labor force costs corresponding to the taxation of low-wage earners.

According to Eurostat's definition, a low-wage earner is someone who earns no more

than two-thirds of the average gross hourly income in the country where they work. At the same time, it should be noted that the results reflect the particularities of the wage taxation systems in each of the countries considered, as can be seen from the following [19]:
Bulgaria applies a fixed % rate of 10% on most income. The employee's contribution amounts to 13.78% (10.58% social security and 3.2% health insurance). The employer must pay a contribution of 18.92% (14.12% and 4.8% respectively).
The Czech Republic applies two rates: 15% on up to €60,000 per year and 23% on over €60,000 per year for all types of income. Income from employment and self-employment is subject to social security and health insurance contributions. In the case of salaried activities, the employee's contribution is equal to 7.1% (social insurance) and 4.5% (health insurance). For the employer, they are 24.8% and 9% respectively.
Hungary has a flat-rate income tax (LCT) of 15%, generally applicable to both active income (e.g. salaries) and passive income (e.g. capital gains, dividends, etc.). A tax deduction is applied in the case of tax on active income. The employer's social insurance contribution is 13% from January 2022, while the employee's contribution is 18.5%.
Poland applies a progressive salary taxation system based on scales ranging between 12% and 32%. Certain categories that conduct specific activities may opt for a flat rate of 19%. For social insurance, the employee pays a social contribution of 13.71%, while the employer pays approximately 20.48%. The employee is also obligated to pay a health insurance contribution of 9%.
Regarding Romania, several clarifications have been made along the way, but it is necessary to point out that the fiscal burden is also reduced for Romanian employees through the granting of deductions (tax exemptions), which are related to the level of salary (above a certain level, they are no longer granted, being degressive) and the number of dependents (in relation to the average gross salary in the economy), but also to age (up to 26 years).
As a concept, the fiscal burden represents a measure of the difference between the employer's labor costs and the employee's take-home pay. It is calculated by reporting the total consisting of income tax, social contributions borne by the employee and those allocated to the employer (together with any payroll taxes) minus benefits, as a percentage of labor force costs. The level of the fiscal burden shows the extent to which a tax on labor discourages or encourages employment, as it reflects the share of labor costs given as tax liabilities to the state budget (Figure 3).
In the European Union, low pay is a reality for a significant percentage of the working population, with Romania and Bulgaria being the countries with the highest numbers of employees in this situation. Eurostat data from 2022 show that almost a quarter of workers in these two countries earn less than two-thirds of the average gross wage.

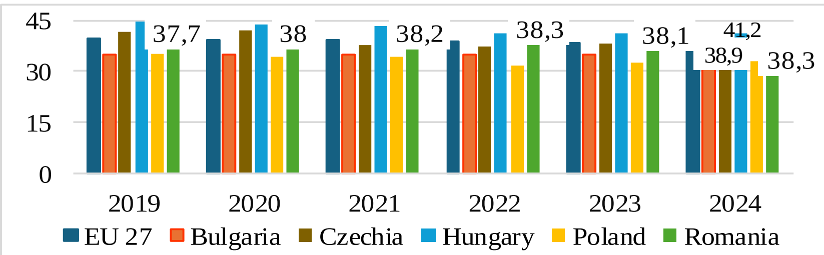

Figure 3: Tax rate on low wage earners:
Tax wedge on labor costs, Source: Eurostat, Author processing

The data presented in the graph shows that all countries have labor tax costs above 30%, but the highest level is in Hungary with over 40% per year, even though this country applies a flat-rate tax system. The Czech Republic also stands out, with a progressive tax system and a tax cost of labor that exceeds Romania's in 2024 (38.9% compared to 38.3%). The levels of each country's tax burden on labor costs are particularly suggestive, as it is believed that high reliance on taxation of labor income often leads to high tax burdens on workers, which can lead to employment decline and flight to the underground economy.
The proportion of total taxes on labor, as a percentage of total taxes on earned income, that each party to the employment contract, employee and employer, is responsible for is reflected in Figure 4.

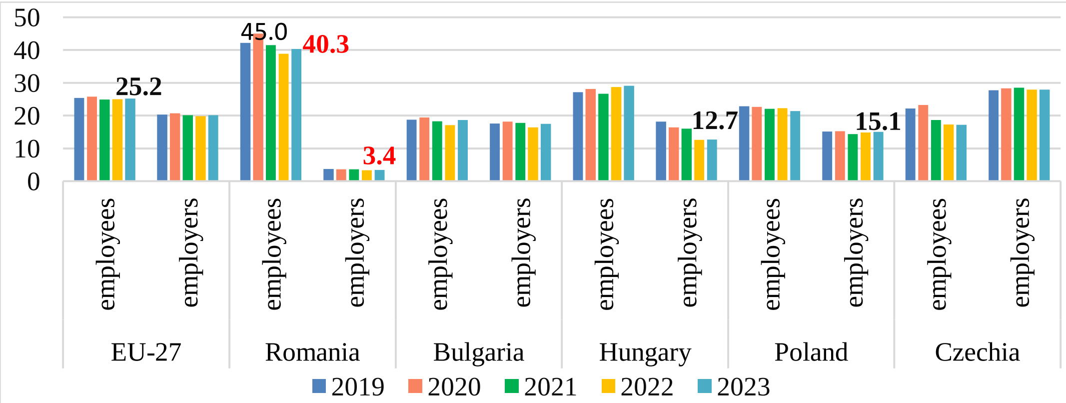

Figure 4: Taxes on labor as % of total taxation - Income from employment, paid by employees and by employers, Source: Eurostat, Author processing

It is easy to see that employees in Romania give a large part of their salary to the state, in the form of taxes and fees paid (40.3%, in 2023), as part of the tax burden on labor (the amount of social security payments is not capped, no matter how high the salary is!). As a result, the employee's tax burden reflects the average personal tax rate, which is the percentage ratio of the amount of income tax and social security contributions, which are imposed on him/her as an employee, to the gross earnings realized.
In fact, the data highlights the transfer to the employee of the tax burden arising from the payment of social security contributions (25%) and health insurance contributions (10%), calculated by reference to their gross salary. Employers in Romania bear a reduced tax burden, consisting mainly in the payment of the labor insurance contribution (2.25%) and contributions related to the working conditions, as the country, as mentioned above, applies a flat-rate tax system.
The lowest levels of employers' tax burdens, in terms of labor taxes as a share of total taxation, are borne by employers in Romania (3,4%), Hungary (12.7%) and Poland (15.1%), the last country with a progressive payroll tax system.

5. Conclusions

Each country applies the labor taxation regimes it considers adequate to the specificity of its own economy and labor market, but takes into account that through promoted fiscal-budgetary policies, it supports strategic objectives of economic development and social security. The impact and performance of each taxation regime depends not only on the provisions contained in fiscal norms, but also on the implementation of provisions and compliance with rules established for taxpayers on one hand, and state institutions on the other hand.

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