

WHITE BOOK



PROPOSAL FOR IMPROVEMENT OF THE INVESTMENT CLIMATE IN MOLDOVA

2005

FOREWORD OF THE PRESIDENT

Right after gaining its independence in 1991, Moldova committed itself to overcoming local vestiges of planned economy and to paving the way for a free market economy. Having new doors opened, investors from abroad gained increasing interest in the region and tried to find a favorable niche for their businesses in a country that had for so long been unknown to many people in the world. Throughout the last fifteen years, the Government has tried to put the Moldovan economy on the right track, but the instability caused by various internal and external factors could never be easily contained. As a response, today, established foreign investors decided to unite their efforts so as to become a reliable and trustworthy partner for the Government in its aim to promote the growth of Moldova, by helping improve the business and investment climates therein.

The belief was, is and shall always be in line with a Moldovan saying, whereby *two* minds are better in that they can generate greater impact. FIA is truly devoted to the credo of a more prosperous Moldova and is convinced that through a concerted effort between the public and private sectors of the country, the wounds of the transition period can be healed in a much faster way, and, most importantly, prevented from recurring in the future.

I would like to take on this opportunity and acknowledge the fact that the Government of Moldova has become much more open to dialogue with the foreign investors. FIA has highly welcomed the Government's invitation to take part in the implementation of the first regulatory reform in the country, and also appreciates its treatment as a consultative partner on various policy matters.

This first edition of the White Book is intended to strengthen the open dialogue that has been established with the state authorities throughout the past year. It is a *book*, because it draws on the actual experience of the FIA members with problems on the ground, bringing in knowledge of specific issues of concern. It is *white*, because its main objective is not to criticize, but rather to offer recommendations for improving the investment climate in Moldova, following best world practices.

The White Book should be viewed as a document proposing very concrete recommendations that are feasible in the short and medium-term. It is our belief that if accepted, these recommendations can have an immediate positive impact on the country's investment climate, thereby raising its attractiveness to investors from abroad.

FIA would like to express its readiness to discuss in details the issues and proposals presented in the White Book with the competent authorities in any format and at any time of convenience.

The first edition of the White Book is not exhaustive in terms of the topics covered. The publication of the White Book should be seen as a process repeated on a regular basis. In the future, FIA intends to broaden the range of areas discussed by preparing supplements on specific sectors.

The book represents the joint effort of the FIA members and its permanent staff. On behalf of the FIA members, I would like to thank all of those who have contributed in any way to the elaboration and publishing of our first White Book edition. I would like to hope that this work will serve not only as a valuable guide to Moldovan policymakers, ambassadors, international organizations, and existing investors, but also as a helpful tool for potential foreign investors.

Chişinău 2005



Joachim Schreiber
FIA, President

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ABOUT FIA IN MOLDOVA

The Foreign Investors Association of Moldova incorporates the leading foreign investors in the country, representing multinational companies that provide a wide range of goods and services for the Moldovan economy. Currently, the FIA has 17 members, whose combined investments in Moldova exceed US\$360 million, while employing more than 6,000 people.

HISTORY

The Foreign Investors Association was founded by 8 foreign investors in Moldova with support from the OECD - Investment Compact for South-East Europe, at the Constituent Assembly on September 22, 2003 in Chişinău, Moldova. The FIA is established as a non-profit business association of foreign investors and was registered with the State Registration Chamber on September 7, 2004.

OBJECTIVES

The member companies of the Foreign Investors Association believe that through a consolidated experience sharing and joint coordination of forces between foreign investors and policy makers, a clearer picture of the concrete challenges affecting the investment climate in Moldova can be created, together with a more constructive framework for providing solutions. The *general objective* of FIA is to contribute, together with public authorities, to a better investment environment for foreign and direct investments through an open and informal dialogue among various stakeholders. The *aims* of the FIA are the following:

- ✔ To contribute to the improvement of the investment and business development climates in Moldova;
- ✔ To represent, express and advance the shared opinions of its members, in order to promote a common interests and stimulate foreign direct investment;
- ✔ To promote communication, cooperation and a continuous dialogue between the Association and public authorities in Moldova;
- ✔ To cooperate with public authorities in Moldova, in order to overcome difficulties and obstacles that may exist in the relations with foreign investors and economic relations with other countries;
- ✔ To promote the interests of the international business community in Moldova;
- ✔ To inform its members and other interested parties, to the extent possible, about the investment climate in general in Moldova.

FIA BOARD OF DIRECTORS 2004-2005

Joachim Schreiber	Chairman, President of FIA	Tirex Petrol
Francis Gelibter	General Manager	Voxtel
Ovidiu Crişu	Moldova Operations Manager	Lafarge
Vasile Nedelciuc	Research/Development Manager	Compudava
Iaakov Tichman	General Manager	Efest Vitanta Moldova Brewery

MEMBERS OF THE FOREIGN INVESTORS ASSOCIATION

Carmez International – (Belgium)
Ciment – Lafarge Group (France)
Compudava – Brains Direct (UK)
Efes Vitanta Moldova Brewery – Efes (Netherlands)
Kentford Capital Corporation – (Greece)
Knauf International – Knauf (Germany)
Leogrant – Summa (Turkey)
Metro Cash & Carry Moldova – Metro (Germany)
Moldavian Airlines – (Switzerland)
Moldcell – Fintur Holding (Netherlands)
PricewaterhouseCoopers – PwC International Ltd. (UK)
QBE Asito – QBE (Australia)
Südzucker Moldova – Südzucker (Germany)
Sun Communications – (USA)
Tirex Petrol – Marquard & Bahls (Germany)
Trans Oil Ltd. – (USA)
Voxtel – France Telecom (France)

EXECUTIVE SUMMARY

The first edition of the Moldova White Book is written against a background of important policy developments that shall mark Moldova's step into the future. The political turn towards EU integration has had and is expected to continuously generate positive implications on local businesses and the investment climate overall. The gradual incorporation of the *Acquis Communautaire* into the Moldovan legislation and practice has a potential to foster a better acknowledged environment in the country, thereby stimulating potential investors to deploy resources herein.

Although the country has indeed registered significant growth rates over the last years, the structure of growth is not very encouraging. Expansion has in most part been driven by growing remittances from abroad, while investments, including fixed capital investments, have stayed below what is needed. This issue is of great concern, as it places a question mark over the sustainability of the growth that Moldova has displayed so far.

From another standpoint, a consumption-led growth may be seen as rather favorable for consumer businesses. However, this is only from a medium-term outlook. Looking far ahead, there are some important and feasible improvements that can be done today, which in the short and medium, but most importantly, in the long run shall have a vital spill-over effect in terms of greater business longevity and efficiency, and also greater attractiveness for investors from abroad.

The first edition of the White Book presents recommendations for improvement of the investment climate in a range of areas. The following issues are particularly significant:

BARRIERS TO FOREIGN DIRECT INVESTMENTS

- ❑ Provisions of different laws are at times contradictory
- ❑ Legislation may be amended as a reaction to one violation with punitive implications for all
- ❑ Judicial system is inefficient and non-transparent, with no mechanism of accountability for judges
- ❑ Enforcement of laws is selective
- ❑ There are instances of direct state interference with business activity
- ❑ The shadow economy punishes legitimate companies and rewards the ones in grey
- ❑ Companies with foreign capital are prohibited from purchasing farm land
- ❑ There is no Western bank represented locally
- ❑ Business financing is very constrained
- ❑ Transportation infrastructure has depreciated considerably
- ❑ Development of "transit" businesses is almost impossible

Major Recommendations are:

- ❑ to foster merit-based judge-related procedures
- ❑ to stop circumvention from VAT payments by companies in grey
- ❑ to attract Western banks
- ❑ to attract foreign investors in the (re) building (and operation) of roads
- ❑ to reduce the fiscal mandates of customs units

ADMINISTRATIVE CONSTRAINTS

- Registration procedures are not fully centralized
- Reporting procedures are cumbersome
- Number of controls and inspections is excessive
- Presumption of innocence is not respected

Major Recommendation is:

- to ensure a more transparent, streamlined, and less burdensome framework of state regulation and interference in enterprise activity

LEGAL FRAMEWORK REGULATING COMPANY OPERATIONS

- Restriction that net assets be at least equal to share capital is burdensome
- Disproportionate weight is given to the rights of minority shareholders

Major Recommendations is:

- to balance the rights between minority and majority shareholders

LABOR RELATIONS

- There seems to be a disbalance between the rights of employers and employees
- Power of individual employment contracts is undermined by collective contracts and conventions
- Provisions regulating conflict of interests are absent

Major Recommendations is:

- to balance the rights of employers and employees, while strengthening the power of the individual employment contract

TAXATION

- Reinvested dividends are subject to taxation
- Tax incentives for investors are ambiguous
- Current mechanism regulating loss carry-forward is inefficient

Major Recommendations are:

- to ensure the continuity and equality of incentives granted to foreign and local investors
- to modify the current loss carry-forward mechanism

SECURITIES MARKET

- Recent amendments to the Law on Securities Market open the capital market to greater state interference
- Distribution of share to strategic partners must necessarily undergo a public offer

Major Recommendations are:

- to streamline procedures allowing operations with own shares
- to annul some of the amendments made to the Law on Securities Market
- to allow distribution of shares to strategic partners, without undergoing a public offer
- to annul the fee levied on shares issued internally

BARRIERS TO FOREIGN DIRECT INVESTMENTS

The present chapter shall present the major obstacles that the members of the FIA see in front of existent and potential investors in Moldova. The issues below have been collected from the practical experience of the members, covering sector-specific aspects, but in most part – aspects with general connotations and implications.

RULE OF LAW

Positive Signs:

- ▣ **First steps are being made for the harmonization of legislation with EU standards.** The National Plan recently approved by the Government to support democratic reforms in the country envisages judicial reforms, including harmonization of national legislation regarding the functioning of the judicial system with European standards.

Legislation

Issues:

- ▣ **Numerous contradictions are present between different legal provisions.** Nowadays situation shows the presence of contradictions between articles of the same Law and contradictions between different Laws regarding the same subject. These aspects may lead to contradictory interpretations, thus undermining the trust in proclaimed supremacy of Law and equitable judicial system.
- ▣ **Some policy uncertainty exists with unfair implications for legitimate businesses.** At times, the legislation seems to be amended not as to improve the overall legal framework, but instead to serve as a reaction - with punitive and preventive character - to specific cases of violations. Besides the fact that this brings in policy uncertainty, through the application of new legal restrictions legitimate businesses are punished on an undeserved basis.

Recommendations:

- ▣ To review the in-force legislation, so as to eliminate contradictions between various legal provisions. When adopting new acts or amendments to existing legislation, to ensure that the “domino” principle is respected, whereby references from other outdated legislative acts are eliminated.
- ▣ To ensure prior consultation with business representatives and other stakeholders for all legislation to be approved.
- ▣ To stop the practice of amending the legislation as a reaction to separate cases of violations, as new restrictions affect not only violators, but all participants on the market. Instead, amend the Code of Administrative and Criminal Contraventions (as applicable by case) in a way that will punish violations in a more efficient manner.

Judge-Related Aspects

Although some dissensions do exist, the legal framework of the Republic of Moldova is a rather good one at its core. The main problem lies in the degree to which its functioning and application is made to be unambiguous. In the same time, in any country espousing democratic and free market economy principles, a correct functioning and application of a legal framework can only be guaranteed through a judicial system that is competent, functional and impartial.

Issues:

- ❑ **Judge-related procedures are non-transparent.** The procedures related to judge selection, dismissal and discipline - as well as supervision of such procedures - are lacking in transparency, a fact that significantly deteriorates the public perception of the judicial system and overall trust in its efficacy.

- ❑ **No established mechanism of accountability exists,** which would hold judges responsible for their actions, thereby reducing incentives for objective and exhaustive decision-making.

Recommendations:

- ❑ To strengthen the selection criteria of judges, so that they are no longer appointed, but elected instead.

- ❑ To improve the remuneration of judges, in order to reduce incentives for corruption. To investigate biased judges and to prosecute them, if called for.

- ❑ To establish an accountability mechanism for judicial staff, as well as stricter rules for judicial oversight.

Implementation

Issues:

- ❑ **Court decisions are not well thought through.** Court decisions in relation to commercial litigation are often seen as lacking in consistency, timeliness and support of clear argumentation.

- ❑ **Enforcement of laws and regulations is selective.** Investors need to have confidence that laws in the commercial sphere will be impartially enforced and that judicial processes will operate effectively and objectively even in the case when State Bodies or Companies are a part to a legal dispute.

Recommendations:

- ❑ To ensure that court decisions are applied from the issue date.

- ❑ To ensure that the legislation is applied impartially.

COMPETITION

Institutional Aspects

Issues:

- ❑ **An independent Agency for competition promotion and protection has not been established yet.** Although there have been made important steps towards ensuring a legal framework for the protection of competition, the institutional and functional frameworks, on the other hand, have remained more than a couple of years behind. *At the moment that the present edition is completed, we nevertheless observed some initiatives to this aim from the part of the Government and we believe that the Agency will be established in the nearest future.*

Recommendations:

- ❑ To establish an independent Agency for competition promotion and protection, based on best world practices. It is further vital to ensure that the Agency activities will follow these principles, so that violations committed only by some market participants do not lead to the instituting restrictions for all. To this point, it is important that the Agency establishes a mechanism, whereby only violators are made to bear the burden of penalties ensuing from committed breaches.

State Intervention

Issues:

- ❑ **State restriction on cereal exports is contrary to market economy principles.** According to a Government Decree, cereals (and namely, wheat, barley and oats) may no longer be traded freely, and their export has to be carried out through the Moldova Commodity Exchange.
- ❑ **In some cases, customs authorities tend to go beyond their mandated prerogatives.** This is in the context of the issue above: although the respective Decree has been intended for only three categories of grain, there were cases when at customs restrictions on exports were extended for all types of grain, including sunflower seeds. Here, the issue is not the existence of the Decree per se, but the ability and use of this ability by customs authorities to abuse in their powers.

Recommendations

- ❑ To initially limit and finally cancel all state subsidies to state-owned enterprises (debt cancelling, fiscal holidays or any other form), in order to eliminate loss-generating companies and level the competition field.
- ❑ To revoke the Decree whereby cereals may not be freely traded.
- ❑ To clearly and explicitly define limits for state intervention in business activities and cases where state intervention in the economy is allowed

Grey Economy

Issues:

Today, the effect of the grey economy is such that legitimate companies end up being punished with a disproportionate tax burden. Another effect is that illegitimate companies are rewarded (and increasing) advantages either in the form of much higher profit margins or, more commonly, in their ability to offer far lower prices:

- ❑ **Evasion from VAT payments on unregistered revenues undermines competitiveness of legitimate companies.** Companies that collect cash from their customers on unreported revenue avoid remitting VAT on this revenue that legitimate companies pay, automatically increasing their profitability by 20% over that of legitimate companies.
- ❑ **Salary payments made through “envelopes” circumventing salary taxes.** As such, companies operating in grey end up avoiding payments of nearly 60% of salary-related taxes (including the employer and employee portion of the tax).
- ❑ **Purchase of materials from cheaper but non-invoice issuing places allows to circumvent VAT payments.** Given that they do not declare officially their operating figures, companies in grey need not worry about the ability of sellers to issue invoices for any purchases, provided that the respective products are sold cheaper. In such a way, VAT payments are avoided, thereby increasing the competitiveness of such companies in relative terms.

Recommendations:

- ❑ To detect businesses shunning from paying VATs by evaluating the volume of business. For example, in the hotel service sector to check with police the number of guests registered by hotels.
- ❑ To resolve the issue of illegitimate cash payments for products and services, which have a “dumping” effect on legitimate companies, by instituting mandatory invoices.
- ❑ To conduct audit of individuals, by comparing official salaries and actual assets owned.

LAND TRADABILITY

This particular issue is worth of special consideration, as it represents an instance where interpretations of current legislation create cases of non-uniform application, in spite of official declarations whereby foreign investors shall be *equally* treated.

Issues:

❑ **Interpretations of present legislation prohibit local companies with foreign capital from purchasing farm land.** Under the present legal framework, only the state and domestic natural and legal persons have the right to purchase farm land. Meanwhile, the definition of a ‘domestic legal person’ – and namely, a legal person having its share capital entirely made up of contributions from legal and natural persons in the Republic of Moldova - is interpreted in such a way as to prohibit companies in Moldova with even the smallest share of foreign capital from purchasing farm land at all, including from the state.

Recommendations:

- ❑ To allow companies with foreign capital to purchase farm land provided that after purchase the purpose of land be changed from farm into industrial. Concomitantly, to establish a time frame for procedures regulating change in land purpose.
- ❑ To allow purchase of farm land by companies with foreign capital involved in the agricultural business, without having to change the purpose of land.

FINANCIAL SECTOR

The present situation in the Moldovan financial sector is not very favourable for the operation of private businesses. First, alternative forms of financing, other than bank lending, are underdeveloped. Interest rates on credits are relatively high, while selection criteria for potential clients are very demanding. Lending is in most part based on collateral. Furthermore, the bank sector is rather concentrated, while non-bank sectors (capital market, insurance) are embryonic. Main issues to address are as follows:

Issues:

- ❑ **Today the access of Moldovan SMEs to financial resources is very limited.** Lending and crediting policies are restrictive, while access to long-term finance is practically non-existent.
- ❑ **No Western bank is represented in the local financial sector.** For the last 4 years, Western banks have been prohibited from opening representative offices in the local banking sector.
- ❑ **Local banks are constrained by past commitments for deposit interest rates.** Today, local banks find themselves in a deadlock as to their inability of reducing interest rates for deposits, due to their commitments to clients assumed in the past.

Recommendations:

- ❑ To analyze possibilities for Western banks to be represented on the local financial market. The presence of Western banks will increase sector competitiveness and diversification of financial services, thereby fostering long-term deposits and from there, possibilities for long-term crediting.

INFRASTRUCTURE

Positive Signs:

- ✔ Air traffic is served by domestic and international airlines, with **air passenger turnover on the increase**.
- ✔ **Telecommunication network is being modernized.** In the last years, Moldtelecom (National Telecommunication Operator) has invested in the modernization of the telecommunication network, by wiring the whole country with a fiber optic network that connects urban centers and provides uplinks to Romania and Ukraine.
- ✔ **Penetration of mobile telephony is on the increase, while mobile services are being diversified on a continuous basis.** Today, mobile services include GPRS/EDGE technologies, IP Telephony, and other.
- ✔ **Internet use has been growing quickly**, although it is still at a low rate compared to other European countries.

Issues:

- ✔ **Country's transportation infrastructure has depreciated considerably during the transition period:** out of the full length of 3,325 km of national roads, 87% have passed their economic lifespan, of which over 30% are in a very bad technical condition. Around 95% of the country's 10,500 km of roads are paved, but are mostly substandard.
- ✔ **Rail-road network has suffered from years of underinvestment**, and is used to transport just under 30% of Moldova's freight. Moldova rail road has no electrified lines.
- ✔ **Implementation of e-commerce is slow.** Although a law on electronic documents and electronic signatures was passed in July 2004, it will take several years before the private sector will be able to bear tangible benefits from a digital signature and other certifications.

Recommendations:

- ✔ To attract foreign companies in the (re) building and operation of national roads. In this case, if the right to operate roads (via concessions) is granted to the respective investors, it shall be financed out of the tolls levied on drivers while using the respective roads – a cost much lower than the car repairation costs due to bad infrastructure. On the other hand, in case roads remain under state property, to revise the present structure of funds for road maintenance (their size, means of collecting road taxes, etc.).
- ✔ Following Moldova's commitment to European integration, it is highly important that the country's infrastructure be compatible with that of the EU states. For this reason, it is high time that the soviet-type railroad gauge be supplemented with a gauge system that would no longer hinder a free circulation of international trains.

CUSTOMS AND EXPORT PROMOTION

Positive Signs:

- ✔ The implementation of the automated tracking system, **ASYCUDA World**, has started in September 2005.
- ✔ **A single joint customs check-point** has been introduced at the Northern border between Moldova and Ukraine.
- ✔ On the whole, **the number of cases of smuggling cases has decreased** noticeably.

Issues:

- ✔ **Today, the customs' fiscal purpose imposes great barriers to the development of "transit" businesses oriented towards export promotion.** The present situation is such that collection of import taxes and VATs falls under the mandate of customs units and is performed right at the border, when this should rather be under the responsibility of fiscal authorities. In fact, the share of customs services in the state budget is increasing (up to 70% at present).

Although the provisions of the previous Law on Foreign Investments, whereby companies with foreign investments were exempt from paying import taxes for imported raw material and accessories used in the production of export-oriented merchandise, have been in most part preserved (with several amendments) after the repeal of the Law, they are not so respected in practice, thereby imposing great burden on the operation of "transit" businesses.

In addition, according to one of the above-mentioned amendments made to previous incentives, import tax exemptions for export-oriented merchandise shall be granted only until 2014. However, the purpose for such a time limit is not clear, especially given that it would be unreasonable to hold exported outputs liable for charges on goods that are imported.

Generally speaking, the conclusion is such that today "transit" businesses are possible either in free economic zones or if operated through active processing ("lohn"). This, however, adversely affects the country, as active processing does not yield local added value.

Recommendations:

- ✔ To reduce the fiscal mandates of customs units, through a tighter collaboration with fiscal inspectorates.
- ✔ To remedy the present situation whereby "transit" businesses are in most part possible only if operated through active processing. In this aim:
 - ✔ To ensure that the legislation regulating incentives for foreign investors (especially, "transit" businesses promoting exports) is respected. To also extend these incentives to local investors.
 - ✔ To annul the time limit imposed on tax import exemptions – until 2014. It is not sure that by 2014 it will be possible and opportune to substitute imports of raw materials used at present.

- ☐ In line with the above, to strengthen the legal framework of customs warehouses in the aim of boosting “transit” businesses as part of export promotion activities.
- To annul provisions requiring that VATs and excise taxes be charged at the moment goods are imported, rather than after they are sold. Such a situation implies that companies must be very liquid, a fact that reduces the level of stock capacities.

ADMINISTRATIVE CONSTRAINTS

Positive Signs:

■ **The Regulatory Reform has been implemented.** The reform has involved the revision of all normative acts regulating enterprise activity (about 1,200 in number), by means of the so-called “Guillotine” Law that came into effect in February 2005. Aimed at canceling those normative acts that did not correspond to market economy principles, the revision followed the principles below:

1. transparency and stability of business activity regulation;
2. respect of legislation by entrepreneurs; giving benefit of the doubt to entrepreneurs when questions arise regarding the application of legislation affecting business activity;
3. no interference with the business activity, including inadmissibility of suspending this activity, except for cases stipulated by law;
4. financing from the state budget (except for cases stipulated by law) of public administration authorities (ministries, departments, etc.);
5. separation of state regulation, control and inspection functions performed by public administration authorities from functions that envision delivery of conformity evaluation services, as well as other services, against a fee;
6. prohibit establishment and perception by public administration authorities of fees for issuance of licenses, authorizations and other certificates/documents pertinent to the business activity, different from the fees established by law and/or resolutions/decisions of Parliament and Government;
7. prohibit establishment and request of documents for issuance of licenses, authorizations and other certificates/documents pertinent to the business activity, other than those established by law as well as Government Resolutions or/and Decrees.

The final version of the Register containing revised regulations was approved by the Government and has been made available through the internet.

■ **A single register for all authorization-related documents has been set up.** Following the implementation of the “Guillotine” Law, a single register has been established, containing all authorizations, permissions, and licenses for entrepreneurial activity that are issued by public authorities, with clearly defined time limits for their issuance by authorities, as well as the amount of fees charged, if any, as specified in the legislation.

■ **One-stop principle for company registration has been implemented.** In accordance with the new Law on State Registration of Enterprises and Organizations that was passed in 2001, company registration procedures have been in most part centralized under the State Chamber for Registration (as part of the Department of Informational Technologies). Furthermore, the law clarifies and reduces the number of documents (from 7-13 to 5) needed to register a business. Today, there is no longer need to separately register with the fiscal authorities and the Statistics Department, as the identification number granted by the Chamber of Registration also represents the fiscal code of the business.

At present, registration procedures take on average one week (and maximum 10 days) and cost about €46/695 MDL - a tax equal for all economic agents, regardless of origins (local or foreign) of the share capital.

Issues:

❑ **Registration procedures are still not fully centralized.** Although important steps have been taken to this aim, businesses still need to apply to CNAM (National House for Medical Insurance) and CNAS (National House for Social Insurance) on a separate basis. In addition, there are no clear guidelines for businesses on what other State bodies they have to register with, and within what time frames.

❑ **The “guillotine” has so far affected only normative acts, while actual laws have been left out.** The revision solely of normative acts revealed the impossibility of the framework created by the “Guillotine” Law to diminish the negative impact on business activity of those regulations that have a Law backup, even if the mentioned regulations are inconsistent with market economy principles.

The FIA welcomes the Parliament decision to follow an action plan for the following four years, aimed at revising the legal framework of Moldova, so as to bring it in conformity with the EU legislation. This would be a great opportunity to combine it with a permanent revision of regulations and to streamline the regulatory reform from bottom to top.

❑ **Reporting procedures are cumbersome.** The number of reports required from any operating company is excessive (for concrete figures, please see Annex A that is illustrating the time and financial costs that one communications company is bearing for providing public authorities with all the required documentation). While bigger companies may relatively well absorb the respective costs, the current reporting requirements bring a large number of smaller enterprises on the verge of bankruptcy.

As an example of unnecessary reporting are the separate statements required by fiscal authorities as proof of tax payments, done on a monthly basis.

Furthermore, the current scheme for filling in various declarations is cumbersome: the absence of a centralized electronic system of reporting leads to the fact that a lot of time and effort is spent on manually writing same data for different forms pertinent to different public authorities.

❑ **Number of controls and inspections is excessive.** The current legal framework enables too great of a number of state bodies to perform audits/inspections in companies - more than 60 in number. The situation is further exacerbated by the fact that inspectors from different public authorities may ask for the same information, which companies are *obliged* to provide in any instance.

❑ **Presumption of innocence is not respected.** There are lot of instances when the purpose of controls is not clearly defined and is not motivated by concrete reasons, as would be, for example, inaccurate data presented in reports. Moreover, most often inspectors have no idea about the contents of those reports at all.

In addition, the presumption of innocence principle is not taken into account at the implementation of tax policies either, which seem to consider any entrepreneur a potential delinquent. The most recent example of this is the initiative to implement separate VAT accounts, following the example of Bulgaria.

Recommendations:

- As a next first step for streamlining registration procedures, to ensure that at any registration performed, the State Chamber of Registration also provides economic agents with a list of other state bodies that they have to register with, as well as respective deadlines.
- Once RIA is put in place, to subject to “guillotine” principles all acts issued by public authorities starting with February 7, 2005 (date when the Guillotine Law came into effect) including.
- To ensure a more transparent and streamlined framework of state regulation and interference in enterprise activity.
- To adopt a *silent approval* clause in addition to the register of all authorizations, following the example of Romania (Emergency Ordinance of the Government of Romania, 2003).
- To streamline the number and forms of reports required. To optimize the reporting system, by making it centralized and electronic.

LEGAL FRAMEWORK REGULATING COMPANY OPERATIONS

OVERVIEW

The legal framework regulating company operations in Moldova comprises the following main legal acts: (i) Law on Enterprises and Entrepreneurship; (ii) Law on Investments in Enterprise Activity; (iii) Law on Joint-Stock Companies; (iv) Law on Free Enterprise Zones; (v) Law on State Regulation of External Commercial Activity; (vi) Law on Licensing Some Types of Activities; (vii) Pledge Law; (viii) Bankruptcy Law; and (ix) Law on Competition Promotion.

Issues:

■ **There is no special law regulating activities of limited liability companies**, although this is the most commonly used legal form in Moldova (followed by joint stock companies).

However, initiatives for preparing such a draft proposal are now on the way. In the meanwhile, the only legal act regulating the activities of LTDs has been a Government Decision on economic units. Accordingly, the minimal amount of the share capital of any LTD must be of 300 minimal monthly salaries (about €346 in total).

Recommendations:

■ To pursue the drafting and adoption of a legal document at the level of Law that will regulate activities of limited liability companies.

LAW ON ENTERPRISE AND ENTREPRENEURSHIP

The Law on Enterprises and Entrepreneurship (LEE) of the Republic of Moldova has been effective since February 1994 and has undergone several amendments ever since. The law defines types of company entities, regulates company incorporation, registration and reregistration, reorganization and liquidation, as well as company organization and governance. Special laws regulate entrepreneurial activity in such sectors as banking, insurance, and securities. For these, provisions of the LEE are applied in conjunction with other legislation pertinent to the respective sectors.

According to the Civil Code and LEE, the following legal forms of business organization are possible, (i) joint-stock company (open and closed); (ii) limited liability company (SRL); (iii) co-operatives; (iv) state and municipal enterprise; (v) general partnership; and (vi) limited partnership, and (vii) sole proprietorship. Banks can only be joint stock companies, while insurance companies can be registered as joint stock companies, limited liability or state companies.

The Law clearly stipulates that foreign citizens carrying out entrepreneurial activity on the territory of the Republic of Moldova have the same rights as Moldovan citizens.

Issues:

■ **There is no time frame regulating the liquidation process**, a fact that may lead to great delays until the process is completed altogether.

Recommendations:

- ✔ To amend liquidation provisions so as to prevent great delays in the completion of the procedure.
- ✔ The statute of a leasehold enterprise is outdated, therefore to eliminate it altogether.
- ✔ In addition, to no longer give a separate organizational form to “state and municipal enterprises,” and instead place them in one of the other forms stipulated by the legislation, such that the state/municipality becomes owner or shareholder.

LAW ON INVESTMENTS IN ENTERPRISE ACTIVITY

Today, the main piece of legislation regulating investment activity, including foreign, is the Law on Investments in Enterprise Activity (LIEA) that came in force in April 2004, when the former Law on Foreign Investments (LFI), effective since 1992, was abolished. According to the new Law on Investments, companies with foreign investments can be either of mixed type (capital made up only partially of foreign investments) or companies with foreign capital (share capital made up exclusively of foreign investments).

Positive Signs:

- ✔ **A new article on transparency has been included in the LIEA.** Accordingly, public authorities must make public consultations before implementing their proposed investment policies, and must make investment data available upon request from any investor.

Issues:

- ✔ **Terminology used is often vague, unclear and inappropriate.** This is an important drawback, as it provides for broad discretionary interpretations. Such terminology includes *investment, reorganization, investment activity, public authority, investment litigation, etc.*
- ✔ **Provisions regulating damage compensation are not clearly specified.** The Law states that damage is equal to the actual value of the damage at the time it occurred. However, it is not clear how this damage is to be determined and by whom.

Recommendations:

- ✔ FIA welcomes the inclusion of the transparency provision into the law, and is hopeful that the Government will give due consideration to the commitment of running public consultations before implementing investment policies.
- ✔ To clarify ambiguous terms and phrasings in the Law, in accordance with world best practices and OECD principles.

LAW ON JOINT STOCK COMPANIES

Joint stock companies in Moldova are regulated by the Law on Joint Stock Companies effective since 1997. Accordingly, two types of joint stock companies can be established: open (listed or not listed) and closed. All such companies must register their shares with the National Securities Commission.

Positive Signs:

- ✔ **Forced payment in dividends has been revoked.** Before, according to some amendments made to the legislation in 2004, joint stock companies were forced to repay minimum 30% of yearly profit in dividends.
- ✔ **Process of publishing information about the summoning of a General Assembly has been eased.** According to the new amendments made to the Law on JSC, information about holding a General Assembly needs no longer be published twice, at an interval of 10 days. From now on, closed joint stock companies may choose not to publish the respective information at all, while the open ones are required to publish it only once.
- ✔ **Clarifications have been added to the case when the General Assembly cannot be summoned.** New amendments made to the Law on JSC introduce a provision stating what is to be done in case none of the administration bodies is capable of summoning the General Assembly. Namely, these functions are to be exercised by shareholders owning at least 25% of shares with voting powers.
- ✔ New amendments made to the Law on JSC establish **a clearer framework as to how the market price for securities shall be set.**


Issues:


- ✔ **Obligation that net assets be at least equal to the share capital of joint stock companies raises important concerns.** Such a restriction dictates the period in which a company must not only become profitable, but also be able to cover all losses incurred in the meantime.



The requirement above is too restrictive, as it means that any - even minimal - loss is taken into account. The Law does not stipulate exactly the period in which measures have to be taken by the General Assembly to remedy the situation. It seems that immediate action is required, which constitutes a major constraint on company activities, as profits may be accumulated over time. Furthermore, the Law prohibits companies facing this problem from internally issuing new shares, as a solution to their situation. As a result, companies are no longer capable of making investments, and thus extend their businesses.


- ✔ **Disproportionate weight is given to the rights of minority shareholders:**
 - ✔ The Law creates a legal framework, whereby the procedure for increasing the share capital by additional shareholder contribution can be totally blocked by minority shareholders (even by one of such). This is especially important in cases when new issuance is seen as a solution to the problem of net assets being less than the share capital.
 - ✔ **Summoning of company meetings.** According to the Law, in case the Board has not made sure that all shareholders (no matter how accessible they are, especially


in rural areas) are informed about holding the General Assembly, the executive body of the company shall summon the meeting at the request of *any* shareholder (regardless of how much voting power he has). Furthermore, any shareholder owning at least 5% of shares with voting powers has the right to summon an extraordinary meeting of the company's Board.


-  **Too much power for initiation of liquidation procedures.** The Law provides that any shareholder owning at least 5% of shares with voting powers may submit to court a request for company liquidation, if during two or more General Assemblies company shareholders failed to elect the Board.

 -  **Request for extraordinary audits of company financial operations.** Shareholders owning at least 10% of shares with voting powers are allowed to request an extraordinary audit of company financial operations. However, the law does not specify under what circumstances “extraordinary” controls are warranted, how often they may be performed, and who is paying for those.

 -  **Provisions regulating bank activities are not consolidated.** As banks may only be established in the form of joint stock companies, regulation of their activities is framed within the stipulations of the present law. In the same time, however, the Law on Financial Institutions establishes a framework whereby bank operations shall be subject specifically to its provisions.
- Recommendations:**
-  To decrease the current minimal level allowed for net assets, from 100% to 50% of share capital.

 -  To provide that following the occurrence of the situation when net assets are less than the share capital, the ordinary shareholder meeting shall decide to go on or liquidate the company (75% vote). If the vote is to continue, to allow a period of up to 2 years for the company to remedy the situation and only after that the General Assembly shall decide on the subject: a) to decrease the share capital down to the minimal required level of net assets; b) to increase net assets (if the cumulated net profits over those two years did not remedy the situation).

 -  To establish a procedure whereby minority shareholder holding together less than 25% of shares with voting power will not be allowed to block the decision to decrease share capital or to proceed with issuance of shares through additional contributions, by setting up a level of 75% of all votes for these decisions.

 -  In case net assets exceed share capital, to allow shareholders to make issuance of shares internally - and not through a public offer.

In line with the above, the FIA will welcome any initiative from policymakers aimed at preventing majority shareholders from “squeezing out” minority shareholders, except for special and well-established cases, when proper compensations shall be guaranteed.

LABOR RELATIONS

LABOR CODE

Overview

At present, the foremost legal act regulating labor relations is the new Labor Code that took effect in March 2003, and which reflects legal concepts of Moldova's neighbors, as well as of some Western European Labor Codes and the Convention of the International Labor Organization. Nevertheless, the Code as it is today still contains some vestiges from the Labor Code of the soviet era.

The Code envisages a basic working week of 40 hours, and guarantees at least 28 days of vacation per year to each employee.

The 14 titles of the Code are divided into 392 articles and regulate, among other, the following issues: social partnership, collective regulations, collective labor agreements, work discipline, professional promotion, work protection and material responsibility, labor jurisdiction.

Positive Signs

- ✔ **Written individual employment contracts** have for the first time been introduced.
- ✔ **Litigation procedures have been simplified.**
- ✔ **Modern principles regulation labor relations have been introduced.** The code introduces principles of labor relations, such as freedom of labor, prohibition of forced labor and labor discrimination, protection against unemployment. Under the new code, failure to pay salaries in time or partial payment is considered forced labor.
- ✔ **Regulations for hiring have been improved.** The code introduces the legal framework for implementing an employee trial period of 3 months (6 months for key positions), and makes it easier (in some cases) for employers to hire for a fixed period up to 5 years. The code also provides that employers may check on personal data and skills of applicants before signing the employment contract.
- ✔ **Regulations for firing have been improved.** Conditions under which termination of employment may be initiated by the employer are specifically defined, and include employee's working capability, skills and conduct (including misbehavior, criminal acts in connection with work, absence from work), and other. The severance payment in case of layoff is of an average weekly salary for each year of service, plus up to three average monthly salaries, after the layoff.

Issues

Unfortunately, some clauses of the new Labor Code are restrictive and not well suited for businesses abiding by market economy principles. In some instances the law overprotects employees, thereby limiting employer flexibility. This is a very important issue for an economy, as reduced employer flexibility induces reluctance to hire, thereby creating fewer jobs and thus a smaller tax base, leading to less money for consumption and savings and hence to a reduced economic growth in the end.

An overall analysis of the legislation and regulations affecting labor relations, including from a taxation standpoint, reveal a trend that is in reverse to concepts of youth employment stimulation and facilitation. In fact, some provisions of the code discriminate in an obvious manner against young people if compared to those with greater length of service.

The FIA believes that the following issues are of priority concern:

- ❑ **The new Labor Code does not provide flexible-enough provisions for employment reshuffling and termination due to inadequate skills or misconduct.** The procedure for laying off employees who have committed work abuse or do not possess required qualification is very complicated. The provisions of the code do not address cases when laying off is made specifically on these grounds, while the only article dealing with the laying-off procedure refers just to cases of company liquidation and cutting of jobs.

While it is saluted that the new Code provides important protection for women with children, in some instances such guarantees place an unjustified burden on the optimal operation of businesses. For example, the Code allows for women with two or more children to go on a leave whenever they desire, without specifying the maximum period allowed for such a leave. Furthermore, besides a maternity leave and a child-care leave for the first 3 years of the newborn, women may also apply for a leave to take care of a child aged between 3 and 6 years, while obliging the employer to keep her position. Such a stipulation implies a direct setback in business activity, as a person that has been absent from her work for a long period may be far behind the skills newly required for the same position. The Code also makes it very clear that it is prohibited to lay off women with children under the age of 6, even in cases of work abuse or misconduct.

Under the present code it is also hard to reshuffle pensioners' positions within a company, making it hard for employers to transfer them, without their approval, from managing positions to lower levels. Furthermore, the procedure for ending employment contracts with pensioners altogether is also very complex, if possible at all.

- ❑ **The Code does not promote short-term (seasonal) hiring of staff.** The code establishes very precisely the cases when an individual employment contract may be signed for a fixed period, with the work performed under such a contract being of „a temporary nature.”

In the same time, restrictions on the type of positions that are eligible for short-term placement pose an unjustified burden on business operations, as they constrain the adaptability of business to market fluctuating requirements and industry inherent seasonality.

- ❑ **Period during which former employees may appeal in courts is too long.** The new Code stipulates that employees, including those already laid off, may make court appeals on employment litigation matters within one year from the date it was found out that his or her rights may have been violated. The period of one year is too long for merely applying to courts.

- ❑ **Requirement to provide compensations for cases of business liquidation is not common in market economies.** The Code stipulates that in cases of company liquidation, employees must be paid a compensation equal to the average weekly salary for each year worked at the

company. In addition, former employees must also be paid an average monthly salary during the period of new job search, but not exceeding 3 months.

- ❑ **The Labor Code makes restrictions on some issues that should be allowed for negotiation in the individual employment contract.** The Code places a strict limitation on the length of the workweek, and namely that it may not exceed 40 hours. Hence, an individual employment contract whereby the employee would agree to work above 40 hour per week (in change for some bonuses, for example), would infringe upon the present law.

According to the code, each business trip may not exceed 60 days, regardless of the character of business operations and of the employee's willingness to go on a business trip for longer than stipulated.

Furthermore, the Code strictly prohibits calling on employees to work during holidays, except for some specific cases. However, the list of these exceptional cases seems to be restrictive, as it does not consider a wider range of possibilities in which employees of various businesses may be urgently convened.

Restrictions as those mentioned above are not practical in many industries and employers should be able to negotiate their own contract conditions with potential employees.

- ❑ **Requirement to perform annual planning of employee professional formation¹ is excessive.** The Code stipulates that the employer is obliged to create the necessary conditions and to foster professional formation of employees. In addition, within each unit, together with representatives of employees, the employer must prepare and approve annual plans for professional growth.

These stipulations are excessive, as such planning should be done on a need-basis - a criteria that goes beyond the scope of a legal provision or leads only to formal compliance.

- ❑ **Provisions regulating conflicts of interest are absent.** According to the new Code, any employee has the right to concomitantly sign individual employment contracts for after-work hours with other employers, even without the consent of the main employer. The only restrictions that main employers may make on the signing of such contracts concern some professions that require special work conditions. However, in competitive markets it is a norm to require that employees do not work concomitantly at a competing company, even after work hours of the full-time job. Issues of conflicts of interest must be regulated in the individual employment contracts, which should take supremacy when deciding on granting the right to work for other employers.

- ❑ **Obligation for employees to go on vacations is excessive.** According to the Code, all employers and employees are obliged to schedule their vacation times. This is too excessive of a provision, as employees should be allowed to decide by themselves on whether to leave for vacations, and as employers and employees should be allowed to negotiate the trade-off between vacation time and work for extra bonuses.

¹ Any process of training by the end of which an employee obtains a qualification, confirmed by a certificate or a diploma issues in accordance with the law.

- ❑ **Work inspectors are given too much authority.** According to the Code, work inspectors have the right to freely enter workplaces, at any time of day or night, without any warning. Furthermore, one article of the Code gives the right to work inspectors to actually stop the functioning (by placing a stamp) of business units, although such an authority is not provided in the article on attributions of work inspectors and although another article clearly stipulates that work inspectors are obliged not to directly or indirectly interfere in the activity of units under their control. Also, labor inspectors have recently been granted the right to set fines on the spot, thereby infringing upon transparency criteria.
- ❑ **Power of individual employment contracts is undermined by that of collective employment contracts and conventions.** It is not clear whether collective employment contracts are mandatory or not. However, initiation of collective negotiations - where issues pertaining to collective contracts are also discussed - is mandatory if at least one party has submitted the respective request. Furthermore, the code stipulates that in case within 3 months of negotiations conclusion is not reached on some provisions of the collective employment contract, all parties are nevertheless obliged to sign the contract on clauses that have been coordinated.

There is also an ambiguity with the mandatory character of collective conventions, which unlike collective employment contracts, regulate general (and not only on unit level) principles of labor relations between employee and employer representatives. There also seems to be an overlapping of clauses included in the collective contracts and conventions. Furthermore, collective contracts as well as conventions regulate clauses that are in the same time to be determined in the individual employment contracts, according to the code. These include terms of labor remuneration, compensations for some work conditions, schedule of work and holidays.

The existence of so many labor regulation documents undermines the importance of the individual employment contract, which is the main instrument defining employer-employee relation in market economies.

- ❑ **Too much power is given to employees over decisions on resignation.** According to the Code, an employee must inform the employer about the decision to resign two weeks beforehand. However, if within those two weeks the employer does not sign an employment contract with another person and the employee decides not to resign anymore, the employer is obliged to hire the latter back.
- ❑ **Provision that salaries may not be reduced within a year after their approval is restrictive.** This restriction interferes with the economic freedom of entrepreneurs, and should be let decided in the frameworks of the employment contract.
- ❑ **Limits on the duration of operating unemployment² are restrictive.** According to the Code, the length for this type of unemployment may not exceed 3 months. It is unclear what is to be done if it lasts for more than that.

² According to the Code, the term *operating unemployment* refers to a temporary incapacity of continuing production activities...for objective economic reasons.

OTHER LABOR-RELATED REGULATIONS

- ❑ **Provision that court decisions on labor relations comes into force right away is excessive.** This is a stipulation in the Code of Civil Procedures. In such a case, the legal right to appeal in other courts the decision made is violated (while the possibility to recover eventual compensations to natural persons becomes very limited).
- ❑ **Setting of payment for using the intellectual property created by employees is excessive.** According to a Government Decree, employers must pay the author of an industrial property (IP) 15% of the profit obtained from the use of the respective IP (even if the employee-author is paid a salary for the creation of the IP). This mandatory provision is a direct interference in the entrepreneurial activity performed by the employer. Author remuneration should be let established during negotiations between the employer and employee.
- ❑ **Limits imposed on amounts allowed for business trip-related expenses are restrictive.** According to the Fiscal Code, expenses incurred by employees during their business trips may not exceed some limits specified for each country in part. In case they do exceed, such expenses are considered employee revenue, thus taxed as regular salary. The specified limits, however, are too restrictive, as they do not reflect the real market-valued living expenses for most of destinations (for example, the limits for accommodations in Moldova are Chisinau - €9.7/147 MDL, other locations – €4.5/68 MDL, food expenses €2.3/35 MDL, per day).
- ❑ **Compensations for medical leave are inequitable.** The small size of compensations for medical leave granted to employees with shorter length of service make them refrain from medical treatment altogether, due to the fact that these payments – which are set as function of the salary level – are below salary size (60% for the first 5 years of service, compared to 100% for 8 years of service and above).
- ❑ **Private pension funds are still missing, despite the existence of a relevant legal framework and even of an inspectorate.** The FIA believes that such a hesitation is due to the fact that the current mechanism of collection and distribution of means for pension payments is lacking in coherence and transparency, but also due to the absence of a normative framework regulating private pension funds. For instance, while the contribution of employees to the pension fund is of 2% from the salary fund, it is restricted to an upper limit of €5.4/81.30 MDL per month (based on average salary figures), regardless of whether the salary is of MDL 3,000 or 30,000. In the same time, the size of pensions is computed as function of salary size. Furthermore, the method for computing pensions that is currently in effect is unfavorable for young people, as the salary obtained during first years of service is not taken into account.
- ❑ **Salaries in the real sector of the economy are established through a direct interference by the state.** In February 2004 the imposable income for the first category of employees in the real sector was increased by 29%, while starting with August 2005 – by another 25%. Yet, such increases in no way reflect improvements in labor productivity. In this context, it is worth mentioning that there is a lot of world-wide experience whereby state indeed interferes in the setting of a minimum salary. However, in Moldova such state interference directly affects *all* categories of employees, whose salaries are established based on payments to the first category. Under such unpredictable circumstances, whereby the state can at any time increase salaries to first-category employees, any long-term planning by companies becomes

non-operational. On the other hand, unfounded increases as above reduce chances for business survival and profitability, or may lead to inflation.

Recommendations:

- ✔ To enlarge the scope of the individual employment contract, so as to grant the employer greater flexibility in the determination of terms of work directly with the employee (in light of the issues described above).
- ✔ To ensure greater employer flexibility with regards to short-term employment (regardless of the position occupied) and termination of employment.
- ✔ To provide that the individual employment contract shall become void once an employee reaches retirement age. To further provide that the contract may be extended through mutual agreement, as it is the case with any other individual employment contract.
- ✔ To amend guarantees that are currently granted to women in maternity leave as follows: a position with the enterprise shall be secured, while the possibility to work at the same position shall be conditioned upon the length of the leave – six months at most.
- ✔ To reduce the term within which former employees may make court appeals from one year to three months.
- ✔ To introduce clear regulations of cases of conflict of interest, in accordance with world best practices.
- ✔ To clarify contradictions between articles on work inspectors, in light of non-interference of the latter in business activities. To annul the decision allowing labor inspectors to set fines on the spot.
- ✔ To annul discriminatory provisions regarding the size of compensatory payments for medical leaves. Taking into account the tendency of employees to abuse medical leaves by using them for personal, non-health-related gains, to establish a differentiating mechanism of compensatory payments based on the length of the medical leave (50% for the case when the length is of up to 3 days).
- ✔ Remuneration of the author of an Intellectual Property should be let established through negotiations between the employer and employee, and not be fixed by the legislation.

The FIA understands that a balance between the rights of employees and employers is not an easy task to achieve and is willing to further collaborate with interested stakeholders – public authorities and social partners – to this aim proposed.

TAXATION

The Foreign Investors Association believes that tax regime in Moldova is quite soft if compared to that of neighboring countries. In the same time, it is also quite unstable and unpredictable. The main tax legislation document - the Tax Code – is revised several times during a single year. Given the frequency of amendments, the text loses in consistency, while containing provisions that may lead to contradictory interpretations.

Positive Signs:

- Starting with January 2005, VAT exemptions have been introduced for goods exceeding the value of MDL1,000 per unit, used as fixed assets that contribute to an increase in company share capital. Similarly, exemptions from customs taxes have also been introduced for goods unvalued at MDL1,000 and more per unit, used for import of fixed assets as above.

Issues:

- **Taxation of reinvested dividends reduces incentives for investments.** According to the current Tax Code, starting with January 2005 payments to non-residents are subject to 10% withholding tax, while dividends paid to resident legal persons – to 18% in tax (a figure that also represents the current profit tax). Resident natural persons, on the other hand, are not subject to such type of taxation, regardless of whether dividends received are directed towards increasing company share capital or not.

Taxes as above can be exempt. However, the condition imposed is too restrictive to allow such exemptions be feasible in practice, as they can be claimed only in case when *absolutely all* shareholders decide to reinvest and use dividends as a way to increase company share capital. Such provisions run contrary to best world best practices and principles of the World Tax Code, which also served as base for drafting the Moldova Tax Code.

The Foreign Investors Association considers that this situation significantly diminishes incentives for foreign, as well as local investors to broaden investment activities, given the instituted double taxation of profits, which, in fact, runs contrary to the provisions of the Concept for Tax Reforms, approved by the Parliament in 1997.

It also creates an incentive for domestic investors to change, from a legal standpoint, the type of company ownership: from legal to natural person.

- **Current framework regulating tax incentives for investors is ambiguous.** After the adoption of the Law on Investments in Entrepreneurial Activity in 2004 (which replaced the previous Law on Foreign Investments from 1992), in March of the same year the Parliament adopted a Law aimed at enforcing tax incentives for investments exceeding USD250,000 and USD2 million.

Following the adoption of this latter Law, as well as the abolishment of the previous Law on Foreign Investments, companies with share capital surpassing either of the two above-mentioned amounts, and which under the Law of 1992 benefited from incentives granted for the procurement of fixed assets, may no longer benefit from incentives provided by the new Law on Investments in Entrepreneurial Activity.

In such a way, companies that started to apply for the exemption on procurement of fixed assets (which is still valid) only after January 1, 2005, and later, with an increase in their share capital, apply and get the second exemption, are put in an unequally favorable situation compared to companies that benefited from the exemption granted for procurement of fixed assets *before* March 2004.

❑ **Current VAT incentives are not functional in practice.** Today, in theory fixed assets for the purpose of investments are exempt from VAT payments. On the other hand, according to the existing legal framework, assets can be considered investments only if they are reflected in a corresponding increase of company share capital. However, procedures for modifying the share capital can be onerous, and may entail costs higher than the actual value of fixed assets (for example, amendments to the share capital of joint stock companies may only be made with the summoning and approval of the General Assembly). Therefore, although there are VAT incentives for investments in theory, they are not so functional in practice.

❑ **Incentives for loans from abroad are absent.** Interest accrued on long term loans (more than 3 years) granted by commercial banks are profit tax free. In addition, interest on loans with maturities between 2 and 3 year are awarded 50% discount on profit tax.

Considering the situation of the Moldovan banking system, FIA considers that a similar incentive granted for loans coming from abroad would improve the financial market.

❑ **Current mechanism regulating loss carry-forward is inefficient.** The current mechanism regulating loss carry-forward is such that losses accumulated by the end of a fiscal year can be reported only in equal parts and within a period of only three years to follow. However, such a system turns out to be inefficient in terms of its calculation, functioning and inventiveness for the placement of investments.

❑ **Payment of VATs on losses has an adverse effect on businesses.** Due to seasonal market price fluctuations, or other situations determined by natural conditions and uncontrollable by businesses, sale prices may at times go below the cost of goods sold. This applies both to local producers and importers. According to the present legislation, in such circumstances VATs shall be calculated and paid on the difference between cost and sale price. Such a provision, however, aggravates to a greater extent the financial situation of companies, which are already suffering losses from their operational activity (due to seasonal fluctuations, etc.).

❑ **Deduction of some expenses is difficult or impossible altogether.** According to the Fiscal Code, deductions of expenses are allowed only for ordinary expenses proven to be necessary for the business activity.

Such a provision, however, may lead to contradictory interpretations in various circumstances. As a consequence to this, the business community feels obligated to write and address various letters of explanation to the Tax Authorities, which in its turn makes its replies (interpretations) public. But despite the fact that these replies do not constitute normative acts in their substance and weight, they are nevertheless taken into consideration as “guidelines” by tax controllers when performing inspections at companies.

Thus,

- ☑ **Auditing performed in accordance with IAS/IFRS³.** Expenses on audits can be deducted only if companies can confirm that these expenses are ordinary and necessary in their business activities. For most of investors coming from EU states, auditing according to IFRS is not “necessary” but compulsory.

- ☑ **Training and education.** Today, such expenses are not eligible for deduction. The reason for this, according to the Tax Authorities, is that “the current labor market can constantly provide qualified personnel for any domain of activity, which makes it inappropriate to qualify expenses on training and education as necessary to perform the business activity.” While companies situated outside major cities may lack in qualified workforce altogether, for other such expenses should even be considered investments (e.g. training of airplane pilots).

- ☑ **Membership fees paid to non-commercial organizations.** Today, these may not be deducted. The Government’s lack of confidence in the representation of business associations - mostly due to their form of organization (membership by natural persons) - can be removed by making membership fees eligible for deduction as expenses. This is even more important considering the general positive impact that a qualitative dialog between public and private sectors may have.

- ☑ **Reparation of rented auto-vehicles.** Similarly, these expenses are not eligible for deduction, even though they refer to an operational loan that is necessary for business activity.

Recommendations:

- ☑ The competent tax authorities shall make public their taxation strategy for at least 5 years beforehand.

- ☑ To eliminate the requirement that the share portfolio proportion remains unchanged after dividends are distributed to shareholders in form of shares.

- ☑ To ensure the continuity and equality of incentives granted to foreign and local investors.

- ☑ To grant incentives for loans received from abroad (differing, in terms of amount, period of maturity and purpose) similar to those granted to local banks.

- ☑ To modify the loss carry-forward mechanism in line with the following:
 - ☑ to allow that losses be carried forward for a period of up to 5 years (and not 3 years, as it is at present)

 - ☑ to make it more flexible so as to allow companies to decide on their own how to distribute losses within the available 5 years, including carrying forward 100% of the loss in a single year.

³ International Accounting Standards. International Financial Reporting Standards.

- To eliminate VAT payments on losses accrued.
- To list in the Tax Code the above-mentioned categories of deductible expenses.
- To eliminate VATs on fixed assets altogether.

SECURITIES MARKET

Overview

The securities market in Moldova emerged as a result of the mass privatization process. The Stock Exchange of Moldova opened in 1995, with the legal status of a closed joint-stock company. In 2000, the Stock Exchange gained the status of a self-regulating authority. As such, it has the power to set rules and standards of activities for its members. In the same year a stock exchange index was introduced – CNVM 32 – based on the Dow Jones index (although during the second quarter of 2005 the capital market did not quite follow the fluctuations in the country's GDP). At present, there are 25 companies listed on the Stock Exchange, out of which 8 are banks. Authorized participants (licensed by the CNVM) operate exclusively as members of the Stock Exchange. Since 1998, the National Securities Commission (CNVM) is responsible for the regulation of the market in Moldova, including transparency and public access to information, protection of investor rights, and promotion of relevant legal framework.

The two foremost legal acts that regulate operations of securities market in Moldova are the Law on CNVM (of 1998) and the Law on Securities Market (of 1998). Overall, the legal framework is intended to ensure compliance with international standards on investor protection, information transparency and fair competition.

According to the Law on Securities Market, issuance of shares can be either public (through public offering) or closed. There is no restriction on foreign investors in terms of purchasing securities owned by registered issuers.

Overall, although more than a decade has passed since the onset of the privatization process, the securities market in Moldova is still too underdeveloped to contribute significantly to the better functioning of the country's private sector. From a practical standpoint, taken as a whole the primary and secondary securities markets are not functioning at full capacity. Today the majority of primary stock issues as well as security transactions are used almost only for the preservation/acquisition of the control portfolio.

Issues:

- ❑ **Recent amendments to the Law on Securities Market make the capital market more restrictive and open to state interference.** Specifically:
 - ❑ **A new term *tender for sale* has been introduced.** For one thing, a tender for share sale only doubles the functions of a public offer. For another, since any tender has to be registered with the CNVM, these amendments imply that from now on any placement of securities must also receive the approval of the Commission.
 - ❑ **The definition of *manipulations* on the securities market has been broadened,** thereby fostering greater room for state interference in transactions on the stock exchange.
 - ❑ **Transactions with securities by insiders face greater restrictions.** First, the new amendments extended the definition of insiders by also including first- and second-degree-relatives to any category of insiders, thereby restricting the free

access to completing transactions with securities of a large number of people. And second, if in the previous version of the law only insiders owning 5% and more of issuers' securities were required to perform transactions through tender offers, following the new amendments, *all* insiders (according to the extended definition), even with the smallest share of company securities, must undergo tender offers for any transaction.

- ❑ **Procedure for registering securities is complicated.** Procedures for registering public offers of securities are established by the CNVM. For every public offer, companies must present a long list of documents to CNVM, including documents of establishment with all relevant amendments made, and an authentication of issuer's registration with the state. CNVM's decision on whether to approve or decline public offer registration may take up to one month after submission of all relevant documents.
- ❑ **Operations with own securities require undergoing complex procedures.** Today, such operations as consolidation, fractioning, denominalization call for other complex procedures: conversion of shares into new ones, issuance of new shares, annulment of old shares
- ❑ **Limitations on forms of payment for shares during tenders is excessive and unconstitutional.** The CNVM Instruction on Tender Offer for Securities clearly stipulates that securities can be purchased only by use of financial means, thereby not allowing for payments in the form of other securities. This restriction runs contrary to the Constitutional provision, whereby the state must ensure freedom of trade and of enterprise activity.
- ❑ **Provision that distribution of shares to strategic partners must necessarily undergo public offer is restrictive.** The Law on Securities Market provides for only two types of share issuance: open and closed. However, a legal framework should be created whereby distribution of shares should be allowed to strategic partners not necessarily through public offer, thereby avoiding the risk of speculators' interference in the process of share distribution.
- ❑ **Some technical restrictions on transactions with securities are inappropriate.** Specifically:
 - ❑ **Payer of transaction fees is established by law.** According to a CNVM Decision, the fees set for the purchase or sale of securities are to be borne namely by buyers. This is too restrictive of a stipulation, as the decision on who is to pay the respective fees should be let at the discretion of the parties to the transaction.
 - ❑ **Timing of payment for securities is set by law.** The decision on which of the two operations – payment or handing over – be done first should be settled between parties and not strictly established through legal acts.
- ❑ **Provisions regulating the case when a part of shares has been pledged as collateral by a shareholder are unclear.** It is necessary to make a demarcation by types of operations and to better define the procedure regulating operations with issuer's own shares for cases when one or a number of shareholders have placed shares under collateral. As such, the transformation of the object under collateral, which from a legal standpoint requires the creditor's approval, does not refer to the conversions of old shares into new ones, this in fact

representing a substitution, which is also motivated by the complexity of the procedure as it is today. In the same time, it seems quite unreasonable that an issuer shall not be able to restructure (including restructuring) own capital because a shareholder has placed under pledge even the smallest part of total shares.

❑ **Present fees do not stimulate but rather diminish the value of foreign direct investments.**

Today, any type of issuance is subject to a fee of 0.5%, which is acquired in the form of CNVM's income that is not transferred to the state budget. This is besides the stamp fee that is also levied on any issuance. Although the CNVM is a public authority, the fees levied by CNVM have not been eliminated and have not been subject to the "Guillotine" Law, given provisions of the Law on CNVM. However, we believe that the imposition of such fees is incompatible with the policy aimed at attracting investments, at least for cases of closed issuance (with the purpose to increase the share capital by the value of investments made), and especially for cases when the profit obtained is reinvested.

❑ **Present legal framework leaves room for potential misuse of attributions by CNVM.**

The Law on CNVM states that "the Securities Commission may exercise functions stipulated in the CNVM regulations". However, this wording provides for the possibility that the Commission extends, at its own discretion, own rights and responsibilities. Examples of such include:

❑ **Estimation of securities is required for cases beyond those stipulated by Law.**

According to a CNVM Regulation, securities must be evaluated (by a licensed organization) for the following cases: (1) purchase or repurchase of own shares by the issuer; (2) placement of tender offer; and (3) contribution to share capital. However, according to the Law on Joint Stock Companies, such an evaluation by licensed organization is required only for cases stipulated by laws (and not normative acts, such as regulations) or in cases it was decided to do so by the shareholders' General Assembly.

❑ **Information on tender initiation and results is required to be made public.**

According to the Law on Securities and that on Joint Stock Companies, publishing of information on tender initiation and results is only one of the ways to be chosen for communicating these data. However, the CNVM Instruction on Tender Offer for Securities makes publishing mandatory.

Recommendations:

❑ To adopt a Corporate Governance Code following best world practices, adherence to which shall be on a voluntary basis.

❑ To streamline securities registration procedure.

❑ To streamline procedures allowing operations with own shares. It would be much simpler to merely require amending data on issued securities, which are included in the Register.

❑ To eliminate the term of a tender for share sale.

- The CNVM should set clearer procedures and mechanisms for determining cases of manipulations on the securities market, thereby avoiding too broad of a definition that may engender greater state interference on the respective market.
- To allow distribution of shares to strategic partners without necessarily undergoing a public offer.
- To extend the range of possible forms of payment during tender offers.
- To stop the practice of requiring securities assessment beyond cases stipulated in laws (and not normative acts).
- To amend the legislation so that publishing, as a means for communicating tender data, is no longer mandatory.
- To annul new amendments made to the definition of insiders.

The FIA understands that a balance between the protection of rights of minority shareholders and freedom in action of strategic shareholders is not an easy task to achieve and is willing to further collaborate with competent authorities to this aim proposed.

Reports presented to the authorities / Rapoarte prezentate autorităților
To the Department of Statistics / La Departamentul de Statistica si Sociologie al RM

Nr.	Name of Report / Denumirea Raportului	Description / Descriere	Presentation term / periodicitate	Necessary time for filling, hours/ timp necesar completării	Expenses for filling / Cheltuieli, MDL (1 hour/ 1 oră = 45 MDL)
1	Financial Statement / Raport Financiar	a. Balance Sheet / Bilantul Contabil	quarterly / trimestrial	24	1080
		b. Profit and Loss Report / Raportul privind rezultatele financiare		24	1080
		c. Cash-Flow Statement / Raportul privind fluxul mijloacelor banesti		24	1080
2	Financial Statement / Raport Financiar	a. Balance Sheet / Bilantul Contabil	annually / anual	8	360
		b. Profit and Loss Report / Raportul privind rezultatele financiare		8	360
		c. Cash-Flow Statement / Raportul privind fluxul mijloacelor banesti		8	360
		d. Report regarding the movement of own capital / Raport privind fluxul capitalului propriu		4	180
		e. Attachment to Balance Sheet / Anexa la Bilantul Contabil		2	90
		f. The existance and movement of long-term assets / Existenta si miscarea activelor pe termen lung		16	720
		g. The existance and movement of current assets / Existenta si miscarea activelor curente		4	180
		h. Short-term Accounts Receivable / Starea si modificarea datoriilor pe termen scurt		4	180
		i. Long-term Debt Condition and Change / Starea datoriilor pe termen lung		4	180
		k. Attachment to the Profit and Loss Report / Anexa la Raportul privind Rezultatele Financiare		8	360
		l. Extraordinary Result / Rezultatul exceptional		0	0
m. Income Tax Expense (Saving) / Cheltuieli (economii) privind impozitul pe venit		80	3600		
3	Statistic Report No. 5-c / Raport statistic nr. 5-C	Enterprises expenses and costs / Consumurile si cheltuielile intreprinderii	quarterly / trimestrial	20	900
4	Statistic Report No. 1-invest / Raport statistic nr. 1-invest	Foreign investments in economy of Moldova / Investitiile straine, alocate de catre intreprinderile cu capital strain in economia Moldovei	quarterly / trimestrial	16	720
5	Statistic Report No. EI-7 / Raport statistic nr. EI-7	Export of services / Export de servicii	quarterly / trimestrial	80	3600
6	Statistic Report No. EI-8 / Raport statistic nr. EI-8	Import of services / Import de Servicii	quarterly / trimestrial	44	1980
7	Statistic Report No. 2-CC / Raport Statistic 2-CC	Items, fixed assets put in exploitation and utilized fix capital investments / Obiecte, mijloace fixe puse in functie si investitiile in capital fix utilizate	quarterly / trimestrial	168	7560
8	Statistic Report No. 2-CC / Raport Statistic 2-CC	Items, fixed assets put in exploitation and utilized fix capital investments / Obiecte, mijloace fixe puse in functie si investitiile in capital fix utilizate	annually / anual	42	1890
9	Statistic Report No. 1-trade / Raport statistic nr. 1-comert	The volume of retail trade / Volumul vinzarilor de marfuri cu amanuntul	monthly / lunar	36	1620
10	Statistic Report No. 1-trade / Raport statistic nr. 1-comert	The volume of retail trade / Volumul vinzarilor de marfuri cu amanuntul	annually / anual	3	135
11	Statistic Report No. 7-trade / Raport statistic nr. 7-comert	Retailment network and public catering / Reteaua unitatilor de comert cu amanuntul si retea unitatilor de alimentatie publica	annually / anual	2	90
12	Statistic Report No. 3-trade / Raport statistic nr. 3-comert	Sales and remains of goods / Vinzari si stocuri de marfuri	semester / simestrial	3	135
13	Statistic Report No. 3-trade / Raport statistic nr. 3-comert	Sales and remains of goods / Vinzari si stocuri de marfuri	annually / anual	3	135
14	Statistic Report No. 1-services / Raport statistic nr. 1-servicii	Payable services rendered to population / Volumul serviciilor cu plata prestate populatiei	monthly / lunar	12	540
15	Statistic Report No. 1-services / Raport statistic nr. 1-servicii	Payable services rendered to population / Volumul serviciilor cu plata prestate populatiei	quarterly / trimestrial	4	180
16	Statistic Report No. 1-BE / Raport statistic nr. 1-BE	Energetic Balance / Balanta energetica	annually / anual	42	1890
17	Statistic Report No. 1-tr. (sos) / Raport Statistic nr. 1-tr. (sos)	Motor transport and the prolongation of departmental ways / Transportul auto si lungimea drumurilor auto de exploatare administrativa	annually / anual	31	1395
18	Statistic Report No. 6-m / Raport statistic nr. 6-m	Employee's professional training / Instruirea profesionala a personalului	annually / anual	13	585
19	Statistic Report No. 1-c / Raport statistic nr. 1-c	Staff movment and work stations existence / Miscarile personalului si locurile de munca existente	quarterly / trimestrial	16	720
20	Statistic Report No. 53-m / Raport statistic nr. 53-m	Employee's salary by different position / Cistigurile salariale ale personalului specificate pe functii	annually / anual	2	90
21	Statistic Report No. 1-m / Raport statistic nr. 1-m	Labour / Munca	monthly / lunar	12	540
22	Statistic Report No. 1-m / Raport statistic nr. 1-m	Labour / Munca	annually / anual	3	135
23	Statistic Report No. 1-m / Raport statistic nr. 1-m	Distribution of workers on pay-roll according with accounting salary (Appendix 1) / Repartizarea efectivului de personal scriptic conform marimii salariului calculat (Anexa 1)	annually / anual	1	45
24	Statistic Report No. 1-PM / Raport statistic nr. 1-PM	Protection of labour / Protectia muncii	annually / anual	2	90
25	Statistical Report No. PE / Raport statistic nr. PE	Main Industrial Indices of electric power station / Indicatorii principali de productie a centralelor electrice	annually / anual	31	1395
26	Statistical Report No. ASA / Raport statistic nr. ASA	Annual census questionnaire / Ancheta statistica anuala	annually / anual	8	360
27	Statistic Report No. 4-ap / Raport statistic nr. 4-ap	Remains, receipts and consumption of fuel / Stocuri, intrari si consum de combustibil	semester	6	270
28	Statistic Report No. 1-inf / Raport statistic nr. 1-inf	The enterprises information and technical supply situation / Stadiul de informatizare si ineztrare cu tehnica de calcul	annually / anual	16	720

To National Home of Social Insurance / La Casa Nationala a Asigurarilor Sociale

Nr.	Name of Report / Denumirea Raportului	Description / Descriere	Presentation term / periodicitate	Necessary time for filling, hours/ timp necesar completării	Expenses for filling / Cheltuieli, MDL (1 hour/ 1oră = 45 MDL)
1	Form 2-14/Γ / Forma 2-14/Γ	Declaration regarding the calculation and payment of medical obligatory insurance / Darea de seama privind calcularea si transferul primelor de asigurare obligatorii de asistenta medicala	quarterly / trimestrial	48	2160
2	Form 4 BASS / Forma 4 BASS	Declaration regarding the calculation, utilization and payment of social insurance / Darea de seama privind calcularea, utilizarea si achitarea contributiilor de asigurari sociale de stat	quarterly / trimestrial	120	5400
3	Form REV / Forma REV	Assured person declaration / Declaratia persoanei asigurate	quarterly / trimestrial	80	3600

To the Fiscal Authority / La Inspectoratul Fiscal de Stat

Nr.	Name of Report / Denumirea Raportului	Description / Descriere	Presentation term / periodicitate	Necessary time for filling, hours/ timp necesar completării	Expenses for filling / Cheltuieli, MDL (1 hour/ 1oră = 45 MDL)
1		Declaration regarding the Income Tax from persons which practice entrepreneurial activity / Declaratie cu privire la impozitul pe venit a persoanei, ce practica activitatea de intreprinzator	annually / anual	440	19800
2	Form TVA 02 / Forma TVA 02	Declaration regarding the VAT / Declaratie privind TVA	monthly / lunar	120	5400
3		Anex to Declaration regarding the VAT/Anexa la Declaratia TVA	monthly / lunar	96	4320
4	Form IRV / Forma IRV	Declaration regarding the payed revenue and the income tax stoped form this revenue (including the Attachement) / Darea de seama privind suma	monthly / lunar	144	6480
5	Form IAS 01 / Forma IAS 01	Information about payments form sources different from salary and income tax stoped from this sources / Nota de informare privind platile achitate rezidentilor din sursele de venit, altele decit platile salariale si privind impozitul retinut din aceste plati	annually / anual	52	2340
6	Form Ial 01 / Forma IAL 01	Information about salary and other payments to employee and income tax stoped from this sources / Nota de informare privind platile salariale si alte plati efectuate de catre parton in folosul angajatilor si privind impozitul retinut din aceste plati	annually / anual	52	2340
7	Attachement nr.6 / Anexa nr.6	Information concerning revenues calculated and payd to employee (legal person) and regarding income tax stoped form these revenues / Informatie privind veniturile calculate si achitate in folosul persoanei fizice (juridice) si privind impozitul pe venit retinut din aceste venituri	annually / anual	146	6570
8	Form INR 01 / Forma INR 01	Information about payments of income tax stoped from sources different from salary that was payed to non-resident / Nota de informare privind impozitul retinut la sursele de venit, in afara de salariu, achitate persoanelor nerezidente	annually / anual	21	945
9	Form TAT 05 / Forma TAT 05	Calculation of the tax regarding the territory arragement (including the Attachement) / Darea de seama pe taxa pentru amenajarea teritoriului (inclusiv Anexa)	quarterly / trimestrial	20	900
10	Form TA 05 / Forma TA 05	Report regarding payment for the consumed water (including the Attachement) / Darea de seama a taxei pentru apa (inclusiv Anexa)	quarterly / trimestrial	20	900
11	Form TFD / Forma TFD	Calculation of the tax regarding the usage of autoways collected from the proprietors of vehicules registered in RM / Darea de seama privind calculul sumei taxei de folosire a drumurilor perceputa de la posesorii de vehicule inmatriculate in RM	annually / anual	3	135
12	Form FUNJ / Forma FUNJ	Calculation of the land tax including the Attachment) / Calculul impozitului funciar (inclusiv Anexa)	semester / simestrial	52	2340
13	Form BIJ / Forma BIJ	Calculation of real estate tax (including the Attachment) / Calculul impozitului pe bunurile imobiliare ale persoanelor juridice (inclusiv Anexa)	quarterly / trimestrial	52	2340
14	Attachment to State Tax Inspection's letter nr.17-12/4/08/62 of 04.05.2004 / Anexa la src. IFPS nr. 17-12/4-08/62 din 04.05.2004	Information regarding the bear volume of expenses to use management, marketing, consulting, advertising, maintenance of cars services and the influence of this services to tax load appurtenant to income tax / Informatia cu privire la estimarea cuantumului chletuielilor suportate pentru beneficierea serviciilor de management, marketing, consultanta, publicitate, intretinerea autovehiculelor si influenta acestora asupra obligatiilor fiscale aferente impozitului pe venit	annually / anual	8	360
15		The Cash-in for the Republican Fund of Financial Support of the Population 2\$ / Dare de seama privind incasarile platilor suplimentare de catre companie 2\$	monthly / lunar	24	1080

GRAND TOTAL
2332
104,940.00