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Romanian Tax Laws: an Overview

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This article provides an overview of tax legislation in Romania with a focus on provisions relating to corporate tax, transfer pricing and withholding tax.

The relevant Romanian tax laws are:

- Fiscal Code approved by Law no. 227/2015 (“Fiscal Code”);
- Fiscal Procedure Code, approved by Law no. 207/2015;
- Order no. 222 of 2008 of the President of the National Agency for Tax Administration regarding the Transfer Pricing Documentation (“Order no. 222”);
- OECD Transfer Pricing Guidelines.

I. Corporate Profit Tax

A. Applicability

The revenues of the following entities are subject to corporate profit tax:

- companies tax resident in Romania;
- foreign companies doing business in Romania through permanent establishments;
- foreign companies which obtain revenues from or in connection with real estate transactions or from share transactions in Romanian companies;
- foreign companies and nonresident individuals doing business in Romania through partnerships with or without legal personality;
- resident individuals who form partnerships without legal personality with Romanian companies, for revenues obtained in or outside Romania;
- companies having their registered office in Romania, established according to European legislation.

A company is considered resident if its head office is registered in Romania or has its effective place of management in Romania.

B. Corporate Profit Tax Rate

The standard corporate profit tax rate is 16%.

C. Calculation of the Taxable Profit

This is calculated as the difference between the revenues obtained from any source and the expenses incurred in obtaining taxable revenues throughout the fiscal year, adjusted by deducting non-taxable revenues and adding non-deductible expenses. When calculating the taxable profit, the elements similar to revenues and expenses are also taken into account.

The fiscal year is considered to be the calendar year or the period during which the entity existed, if it was established or dissolved during that calendar year.

D. Non-taxable Revenues

The Fiscal Code provides for several non-taxable revenues such as:

- revenues resulting from dividends received by a Romanian company from another Romanian company;
- revenues resulting from dividends received by a Romanian company from a subsidiary located in an EU Member State, subject to the following conditions:
 - the Romanian company is a registered profit taxpayer; and
 - the Romanian company has held at least 10% of the subsidiary's shares for a continuous period of at least two years until the date the dividends are paid;
- revenues resulting from the cancelation of provisions or expenses that were previously non-deductible, revenues resulting from the recovery of expenses that were previously non-deductible and revenues resulting from reversal or cancelation of interest and late-payment penalties that were previously non-deductible;
- revenues obtained from the sale of shareholding participations held in (a) Romanian companies or in (b) foreign companies located in a state with which Romania has concluded a double taxation

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convention, if, at the date of the sale, the taxpayer has held for a continuous period of at least one year at least 10% of shares of the company of which the shareholding participations are sold. This exemption does not apply if the taxpayer who sells shareholding participations in a Romanian company is resident in a state with which Romania did not sign a double taxation convention.

- non-taxable income expressly provided under agreements and memoranda approved through legal enactments.

E. Deductibility of Expenses

There are three categories of expenses:

- deductible expenses;
- limited deductibility expenses;
- non-deductible expenses.

1. Deductible Expenses

The expenses are deductible only if incurred for the purpose of generating taxable income.

Some of the deductible expenses are expressly mentioned in the Fiscal Code, such as:

- expenses incurred in professional training and development of employees;
- advertising expenses incurred in promoting the company, products or services, based on written agreements, as well as costs related to the production of the materials required for broadcasting advertisements, including goods granted as samples, with product testing at selling units, as well as other goods and services received in order to stimulate sales;
- expenses incurred in marketing, market research, promotion in existing or new markets, participation in fairs and exhibitions, in business missions and with publishing of own brochures;
- expenses incurred in environmental protection and resource preservation;
- expenses incurred in the improvement of management, IT, the introduction, maintenance and development of quality management systems, and in obtaining quality compliance confirmation;
- travel and accommodation expenses related to business trips in Romania or abroad by employees and directors;
- expenses incurred in relation to work safety, prevention of work accidents and occupational diseases, the related insurance contributions and professional risk insurance premiums.

2. Non-deductible Expenses

The Fiscal Code provides for certain non-deductible expenses, such as:

- domestic profit tax and profit tax paid in foreign countries;
- expenses related to non-taxable revenues;
- expenses related to withholding tax borne by Romanian taxpayers on behalf of nonresidents;
- interest, fines and penalties due to Romanian or foreign authorities;
- expenses incurred with the management, consultancy, assistance or other services if no related

agreements were concluded and the beneficiary cannot justify the supply of such services for the activities performed or for their necessity;

- sponsorship and patronage expenses and expenses for private scholarships. However, the taxpayers are granted a fiscal credit up to an amount consisting of the lowest value between 0.5% of the turnover and 20% of the due profit tax;
- expenses recorded without justifying documentation;
- salary expenses which are not taxed at the level of the individual;
- expenses made in favor of the shareholders, other than the ones related to goods or services provided by the shareholders at market value;
- 50% of the fuel expenses for company vehicles weighing under 3,500 kg and with less than nine passenger seats including the driver's seat; the Fiscal Code though provides that in certain cases the fuel expenses are fully deductible.

3. Limited Deductibility Expenses

Certain expenses have limited deductibility, such as:

- depreciation of assets under the regulations related to fiscal depreciation;
- perishable goods within the limits established by the relevant central administration bodies;
- protocol expenses are deductible up to the limit of 2% of the accounting profit, to which the protocol and profit tax expenses are added; the collected VAT related to gifts offered by taxpayers, of which value is higher than 100 Romanian Lei, is included in the protocol expenses;
- daily allowances for expenses from domestic and foreign travel by employees are deductible up to the level of 2.5 times the legal threshold established for public institutions;
- taxes and contributions paid to non-government organizations and professional associations related to the taxpayer's activity are deductible up to the limit of 4,000 euros per year;
- health insurance premiums are deductible up to the limit of 250 euros per year, per employee;
- private pension insurance premiums are deductible up to the limit of 400 euros per year, per person.

4. Provisions and Reserves

As a general rule, provisions and reserves are non-deductible for profit tax purposes.

However, the Fiscal Code provides for certain provisions and reserves which can be considered deductible.

F. Accounting and Fiscal Depreciation

The Fiscal Code establishes a distinction between accounting and fiscal depreciation.

With regard to fixed assets, the fiscal depreciation is calculated according to the provisions of the Fiscal Code. Therefore, the deductibility level of the expenses related to the depreciation of the fixed assets does not depend on the level of depreciation recorded in the accounts.

The calculation of the depreciation of fixed assets for tax purposes is based on the tax value.

The said depreciation may need to be adjusted for revaluations according to the accounting rules.

The fiscal depreciation should be calculated based on the asset's tax value and useful life for tax purposes, by applying one of the allowed depreciation methods:

- straight-line method;
- accelerated depreciation method; and
- reducing balance method.

The Fiscal Code provides an incentive for the purchase of machinery and equipment, computers and their peripherals, as well as patents. These can be depreciated by using the accelerated method which consists of the deduction of a maximum of 50% of the asset's tax value during the first year of usage. The rest of the asset's value can be depreciated using the straight-line method over the remaining useful life.

G. Filing Tax Returns and Payment of Tax

Profit tax returns are filed and profit tax is usually paid on a quarterly basis.

Nonresident companies obtaining income from real estate property located in Romania or sale of shares held in a Romanian company are obliged to declare and pay the related profit tax. For this purpose, such companies may appoint a tax representative or an authorized person to fulfil this requirement. However, if the buyer is a Romanian company or a Romanian permanent establishment ("PE") of a nonresident company, the obligation to declare and pay the said profit tax will remain with the buyer.

From January 1, 2013, taxpayers (with certain exceptions) may opt for computing, declaring and paying the annual profit tax in quarterly advance payments.

H. Loss Carried Forward

The annual loss, as established by the profit tax return, is to be recovered from the taxable profits obtained during the following seven consecutive years. This seven-year period applies starting with the tax loss established for 2009. The tax losses from previous years are carried forward for a period of only five years.

I. Tax Exemption for Reinvested Profit

The reinvested profit is the balance of the profit and loss account, i.e. the accounting gross profit cumulated starting with the beginning of the year. Such reinvested profit, if used for the purchase of equipment, will be tax-exempt. This exemption will be applicable for the year when the respective equipment is put into use.

The tax exemption for reinvested profit is applicable in the case of equipment manufactured and/or purchased as of July 1, 2014 and put into use until December 31, 2016.

Taxpayers which benefit from this tax exemption must retain the equipment in their property for a minimum period equal to half of the commercial life of the equipment. There are certain exceptions to this rule, i.e. if the equipment is destroyed, lost, stolen or sold during the insolvency procedure. This retention period cannot exceed five years.

Furthermore, taxpayers which benefit from this tax exemption may not use the accelerated depreciation method for the relevant equipment.

II. Transfer Pricing

Transactions with Romanian affiliated companies as well as transactions with nonresident related parties are subject to audits regarding compliance with transfer pricing legislation.

When auditing such transactions, the tax authorities may adjust the amount of income or expense of either person as necessary in order to reflect the market price for the goods or services provided in the transaction.

The methods that may be used for setting transfer prices are provided by the OECD Transfer Pricing Guidelines. The Romanian audit authorities also refer to local precedents, and interpretation of relevant Romanian laws.

Taxpayers which perform such transactions must prepare their transfer pricing documentation and make the file available upon the written request of the Romanian tax authorities.

The content of the transfer pricing documentation file was approved by Order no. 222. The said Order is supplemented by the Transfer Pricing Guidelines issued by the OECD Transfer Pricing Guidelines and the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union ("EUTDP").

The deadline for submitting the transfer pricing documentation file must not exceed three months. However, a single extension equal to the period initially established is possible.

Failure to submit the transfer pricing documentation file or the submission of an incomplete file following two consecutive requests will trigger the assessment of the transfer prices by the tax authorities.

III. Foreign Fiscal Credit

Romanian companies are granted a fiscal credit for income taxes paid abroad which cannot exceed the profit tax calculated by applying the Romanian profit rate of 16% to the taxable profit obtained abroad.

In this respect, the Romanian company is required to have on file the documentation attesting the payment of taxes abroad.

Fiscal credits may be obtained in Romania for taxes paid to a foreign state only if the double taxation conventions concluded between Romania and the respective state apply, and based on the documentation which proves that the taxes were paid in the foreign state.

IV. Dividend Tax Payable by Resident Companies

Dividend payments made by a Romanian company to a Romanian resident shareholder, or to a nonresident shareholder, are subject to 16% dividend tax. As of January 1, 2017, the dividend tax will be 5%.

Dividends paid by Romanian companies/companies having their registered office in Romania, incorporated according to the European regulations to other such companies are tax-exempt if the beneficiary of the dividends holds a minimum of 10% of the

shares in the other company for an uninterrupted period of at least one year before the date of the payment.

Dividends paid by a Romanian company or a company that has its registered office in Romania, to a company or a PE of a company resident in an EU Member State are tax-exempt if the nonresident company which benefits from the dividends:

- is set up according to Article 201 (4) of the Romanian Fiscal Code;
- is a resident of the respective state and, based on a double tax convention concluded between the respective state and a non-EU state, the said company is not considered to be a resident with the purpose of taxation outside EU;
- pays profit or a similar tax in their state of residency;
- owns a minimum of 10% of the shares in the Romanian company.

Interest and royalty payments by Romanian companies to other Romanian companies are not subject to withholding tax but are considered as taxable income for the beneficiary and are subject to ordinary corporate profit tax.

V. Consolidation

There is no tax consolidation in Romania between entities which have a distinct legal personality. Starting July 1, 2013, the Romanian tax law allows corporate income tax consolidation between all of the PEs, i.e. management offices, branches, plants, stores, mines, and oil and gas wells which a foreign legal entity operates in Romania, but no change was made with regard to the tax consolidation of entities with distinct legal personality, e.g., subsidiaries.

VI. Capital Gains Obtained by Residents

Capital gains obtained by Romanian resident companies are taxed at 16%.

Capital losses related to sale of shares are, in general, tax deductible.

Mergers, spin-offs, transfers of assets and exchanges of shares between two Romanian companies should not trigger capital gains tax.

VII. Corporate Tax Payable by Branches and Representative Offices of Nonresidents

A. General Issues

Nonresident foreign legal entities are generally subject to Romanian taxation for the revenues sourced in Romania.

Nonresident foreign entities become subject to Romanian taxation by establishing (i) a branch, (ii) a representative office, or (iii) a PE. They also have to pay withholding tax on the Romanian sourced income.

B. Branch

The branch is a mere extension of the parent company; it does not have a legal personality. The activities of the branch are controlled and limited by the decisions of the parent company.

Given the lack of legal personality, the branch itself cannot be a party to a contract. The contract can be concluded by the parent company acting through its branch, or directly by the parent company.

In terms of taxation, there are no major differences between the branch and the subsidiary, i.e. a company registered as a Romanian legal person. From the tax perspective, a branch of a foreign company is considered a taxpayer in Romania, given that the branch can qualify as a PE according to the provisions of the Romanian Fiscal Code.

The first step of the tax registration is performed at the same time as the registration with the Trade Registry, by filing a fiscal registration form with the Trade Registry.

After the registration of the subsidiary/branch with the Trade Registry, the second step of the tax registration can be carried out, i.e. the issuance by the relevant tax authority of the tax registration certificate, or the VAT registration certificate (if the branch will be registered as a Romanian VAT payer). Such formality is usually carried out by the accountants of the newly-registered branch.

The branches must be registered with the Trade Registry and with the Romanian tax authorities.

The distribution of funds to the nonresident parent company is not regarded as dividend distribution, therefore no withholding tax liability arises.

C. Representative Office

A representative office can only perform auxiliary or preparatory activities. It cannot perform trading activities in its own name and cannot engage in any commercial activities.

There is a flat tax of 4,000 euros per year for representative offices, payable in two equal instalments, and a tax of 1,200 euros per year for the renewal of the authorization.

If a representative office is set up or dissolved during the year, the tax due for the respective year is pro-rated for the months when the representative office is operational.

VIII. Permanent Establishment

A PE refers to a taxable presence of a nonresident in Romania. A PE is a place where the activity of a nonresident is conducted, fully or partially, directly or through a dependent agent. The Fiscal Code includes in this category the following:

- a place of management;
- a branch;
- an office;
- a factory;
- a shop;
- a workshop;
- a mine;
- an oil or gas well;
- a quarry or other places of extraction of natural resources;
- the location where a certain activity involving the assets and liabilities of a Romanian legal entity entering into reorganization continues to be performed.

The profit derived from the activity performed of the PE is subject to profit tax.

IX. Withholding Tax

Nonresident companies which are not operating through a PE are subject to tax in Romania for the income from Romanian-based sources. The withholding tax (“WHT”) covered by the double tax conventions to which Romania is a party range from 0% to 15%.

WHT is applicable to the following revenues:

- commissions;
- revenues from services rendered in Romania;
- revenues resulted from the liquidation of a Romanian legal entity.

If there is no applicable double tax convention, the revenues of the respective nonresident sourced from Romania are taxed at the rate of 16%.

There are certain exceptions to the above rate, such as:

- dividends—dividends paid by Romanian companies to companies resident in one of the EU Member States are exempt from WHT, if the dividend beneficiary:
 - is set up according to Article 201 (4) of the Romanian Fiscal Code;
 - is a resident of the respective EU Member State, and based on a double tax convention concluded between the respective EU Member State and a non-EU state, the said company is not considered to be a resident of the EU Member State for the purpose of taxation outside the EU;
 - pays profit or a similar tax in its state of residency;
 - owns a minimum of 10% of the shares in the Romanian company;
- interest and royalties—interest and royalties payments are exempted from WHT if the beneficiary is (i) a company resident in another Member State, or (ii) a PE of a company resident in a Member State, located in another Member State.
- gambling—the applicable WHT rate is 25%;
- revenues paid in a state with which Romania did not conclude any legal agreements providing an exchange of information between the states, i.e. revenues paid in tax havens: as of February 1, 2013, the applicable WHT rate is 50%.

In order to apply the favorable European legislation, nonresidents must submit a tax residency certificate and must issue a declaration attesting compliance with the requirements provided by the relevant EU directives.

As of June 1, 2015, nonresident taxpayers which earn interest income in Romania may opt to apply the tax treatment provided for resident taxpayers. Thus, nonresident taxpayers may opt to register for profit tax purposes in Romania, directly or through a tax agent. The option is available for nonresident legal entities which reside in the EU or in the European Economic Area Member States which concluded double tax conventions or information exchange agreements with Romania.

A. Capital Gains Obtained by Nonresidents

Capital gains obtained by nonresidents from the sale of real estate located in Romania or from the sale of shares held in Romanian companies are taxable in

Romania at a rate of 16%. However, double tax conventions may provide more favorable rates.

B. Double Tax Conventions

Double tax conventions concluded between Romania and the country of residence of the payment beneficiary may provide different WHT rates.

The list of countries with which Romania has concluded double tax conventions is found at http://static.anaf.ro/static/10/Anaf/AsistentaContribuabili_r/Conventii/Conventii.htm.

In order to avoid withholding, the nonresident recipient has to provide the resident payer with a valid tax residency certificate prior to the payment of the income. The tax residency certificate should stipulate that the foreign beneficiary was a tax resident in a country other than Romania, during the period when the Romanian income was obtained.

The tax residency certificate valid for the year for which the payments are made is also valid during the first 60 days of the following year if the residency conditions did not change.

The WHT rates provided by the Romanian Fiscal Code will apply if a tax residency certificate is not available. However, a refund can be requested if the tax residency certificate is submitted during a five-year period following the receipt of income from a Romanian resident.

C. Special Provisions

When establishing the amount of a tax or of a charge according to the provisions of the Fiscal Code, the tax authorities may not take into account a transaction which does not have an economic purpose or may reclassify the form of a transaction in order to reflect the economic content of the transaction. In case the transactions or series of transactions are classified as being artificial, provisions of the relevant double tax treaty will not apply, and the transactions in question will be taxed according to the Romanian Fiscal Code. Artificial transactions are transactions or series of transactions which do not have an economic content and which cannot be normally used within regular economic practices, the essential purpose thereof being to avoid taxation or to obtain tax advantages which could not be granted otherwise.

X. Local Taxes and Other Taxes

The Fiscal Code provides certain local taxes, such as:

- building tax;
- land tax;
- tax on means of transport;
- tax related to promotion and advertising;
- taxes for the issuance of certain certificates, licenses and authorizations;
- tax on revenues obtained from public performances.

A. Building Tax

For buildings owned by companies, the building tax rate is established by the local council at a rate between 0.25%–1.5% of the registration value of the building, adjusted, by case, with the value of recon-

struction, consolidation, modernization, modification and extension works.

If the building has not been reassessed in the previous three years, the tax rate is increased by the local council by 5% to 10%. The taxable value of fully depreciated buildings is reduced by 15%.

The building tax is due twice a year, by March 31 and September 30, and is paid in equal instalments.

B. Land Tax

Owners of land must pay a land tax per square meter, according to the classification established by the municipality where the land is located, and the zoning of the area where the land is located. The zoning is determined by the local municipality.

The land tax is due twice a year, by March 31, and September 30, and is paid in equal instalments.

C. Registration of the Agreements Concluded between Nonresidents and Romanian Entities, and Natural Persons Regarding Certain Services Rendered in Romania

According to Order no. 2310 of 2007, Romanian legal and natural persons have the obligation to register agreements concluded with foreign legal entities or nonresident natural persons which render on Romanian territory services such as construction works, installation works, surveillance works, consultancy works, technical assistance works and any other activities which may be considered a PE in Romania.

These agreements must be registered with the territorial tax authorities in the jurisdiction in which the Romanian legal entities benefitting from the above-mentioned activities have their fiscal domicile, or, in the case of medium-sized and large taxpayers, with the competent tax authority.

D. Contributions to the Social Security System

Under the Romanian employment and tax regulations, both the employer and employee are required to make contributions to the social security system.

1. Social Security Contributions at the Individual Level

- social security contribution—10.5% on the monthly gross income;
- health fund contribution—5.5% on the monthly gross income;
- unemployment fund contribution—0.5% on the monthly gross income.

2. Social Security Contributions at the Employer's Level

- social security contribution—between 15.8% and 25.8%, depending on the working conditions, of the total gross amount paid to employees on a monthly basis;
- health fund contribution—5.2% of the total gross amounts paid to employees on a monthly basis;
- unemployment fund contribution—0.5% of the total gross amount paid to employees on a monthly basis;

- contribution for medical leave and indemnity—0.85% of the total gross amount paid to employees on a monthly basis;
- insurance contribution for labor accidents and professional diseases—0.15% to 0.85% of the total gross amount paid to employees on a monthly basis, depending on the risk class, according to the law;
- contribution to the guarantee fund for payment of salary debts—0.25% of the total gross amount paid to employees on a monthly basis.

3. Contribution to the Health Fund by Foreign Individuals

Citizens of the European Economic Area (“EEA”) countries and Switzerland benefit from coverage of medical expenses incurred in Romania, as well as from exemption from social security contributions. Such exemptions are granted if expatriates obtain the A1 certificate from another EU Member state where their employer is located or the E101 certificate from Norway, Iceland, Liechtenstein, and Switzerland, for expatriates whose employers are located in these states.

If an individual is not subject to social contributions in his or her home country, that person will be subject to the jurisdiction of the Romanian social security system and will be liable to pay social security contributions due under Romanian regulations.

E. Late Payment Penalties

Late payment interest and late payment penalties are applied for late payment of the fiscal claims owed to the State Budget. The late payment interest rate is 0.02% per day.

Other late payment penalties are as follows:

- the late payment penalty is 0.01% per day;
- in case the main tax obligations are established by the tax audit authority to be due to the fact that they were undeclared or incorrectly declared, the late payment penalty is 0.08% per day.

F. Additional Taxes to be Paid by Certain Economic Operators

As of 2013, the following additional taxes have to be paid by economic operators which carry out activities related to the extraction and trading of natural resources:

- special tax of 0.5% applied to the revenues obtained from the exploitation of natural resources, other than gas—to be paid by economic operators which carry out activities related to the exploitation and trading of natural resources;
- tax of 60% applied to the additional revenues obtained from the deregulation of the prices from the natural gas sector—to be paid by economic operators which carry out activities related to both extraction and trading of natural gas.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.