Romania: An Introduction

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The 16% tax on both corporate profits and personal incomes remains unchanged. There have been some discussions to revert to a progressive income tax system, but such discussions have not materialised.

The beginning of 2013 saw notable amendments of the Fiscal Code, some of them largely contested by both tax payers and tax professionals. Romania introduced a special VAT regime for companies with a turnover of less then 2.25 million RON (aprox. EUR500.000), which allows such companies to pay the VAT only after the invoices they issued are paid. Although this was meant to be an incentive for small companies, it caused massive problems for clients that were not allowed to deduct the input VAT until payment of the invoice, which resulted in the closing of small businesses. In addition, Romania is facing an infringement from EU because this measure is compulsory and not optional.

Romania also changed the fiscal regime of micro companies (3% income tax rate instead of 16% corporate tax rate applicable to companies with an annual turnover of less then EUR65,000). This fiscal regime became compulsory for newly established companies too, thus affecting mostly large greenfield investments.

The series of tax changes that are difficult to understand continues with a 50% withholding tax applicable to payments to companies that are located in jurisdictions with which Romania does not have an agreement for exchange of information. However, the 50% withholding tax does not apply according to the country of residence, but according to the location of the bank account. On top of that, the government changed the rule for taxation of services rendered by non-residents - now such services are subject to withholding tax in Romania, even if they are not actually rendered in Romania.

However, there is also good news. The Ministry of Finance is working hard, including through consultations with the tax specialists, to draft a new Fiscal Code which should be enacted in 2014. This new Fiscal Code should replace the existing one, in force since 2004 and should be much easier to follow. If this goes as planned, starting in 2014 Romania will have a much more modern Fiscal Code, and most of the inadvertencies accumulated over the past will be eliminated.

Moreover, there are discussions to cut 5% of the very high social contributions starting with 2014, but this measure largely depends on the economic performance of Romania in 2013 and on the agreement with IMF and EU. Currently, the social contributions paid by employers represent 28.45% of gross salaries and those paid by employees being 16.5% (for a total of 44.95%). The tax base for the pension fund portion of the social contributions (employer 20.8%, employee 10.5%) is capped since 1 January 2011 to five average salaries. However this has a very limited practical effect. The base of calculation for the other portions of the social contributions is not capped.

Nevertheless, the Romanian tax system can be seen as being a modern one, being largely in line with the expectations an investor should have from an EU member country. Romania has implemented the EU VAT and Excise Directives and is on track to implement in a timely manner the subsequent changes to these directives at the EU level. In addition, the Norms of Application of the Fiscal Code make constant reference to ECJ rulings on VAT matters, ensuring consistency in the application of the relevant EU legislation. Such rulings are also observed to a large extent by tax inspectors and the Romanian courts at all levels. Further, Romania has also implemented the Parent/Subsidiary Directive and the Royalties and Interest Directive since 2007. The former was implemented with immediate effect and the latter with a transitory period which ended on 31 December 2010. Consequently, remittances of dividends as well as interest and royalties are now exempt from withholding taxes in Romania, provided however that certain condition is met. Romania also has more than ninety double tax treaties in force which not only can be used to avoid double taxation but also to carefully plan the structure of investments in Romania. Most of these treaties follow the OECD Model Treaty, with only a few of the older treaties following the UN Model Treaty.

Romania has implemented capitalisation rules since 2002, allowing interest paid to non-financial lenders to be deducted only within a limit of 6% and only if the debt/equity ratio is not higher than three. Romania has also implemented transfer pricing rules pursuant to norms fully in line with the relevant OECD guidelines. Starting in July 2010, these transfer pricing rules are also applicable to transactions between Romanian companies.

From a procedural perspective, it is important to note that the Romanian Fiscal Code includes the 'substance-over-form' principle, thus allowing tax inspectors to disregard the legal form of a transaction/business relationship and to reclassify the nature of specific transactions or business relationships to reflect the economic reality. However, for Romania this principle should be read as substance *and* form, the tax inspectors being increasingly more aggressive in their interpretations and have been using all tools for the obvious aim of collecting more taxes. Consequently, investors should be extremely careful not only to give substance to their operations, but also to ensure the form as this is equally important especially for VAT deductibility purposes.

Finally, when differences in taxes are ascertained by tax inspectors, delay interest and penalties will also automatically apply. There are, of course, means to challenge the decisions of the tax inspectors – first in an administrative procedure and later in courts.

Despite all the reasons for criticism, the general trend continues towards the increasing of the modernization of Romania's fiscal legislation, especially for purposes of offering investors a competitive fiscal environment.

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