



Lex Mundi European Union: Accession States Tax Guide

ROMANIA

Nestor Nestor Diculescu Kingston Petersen

CONTACT INFORMATION:

Ana-Maria E. Miron

Nestor Nestor Diculescu Kingston Petersen

Tel: 4021.20.11.200 - Fax: 4021.20.11.210

E-mail: Ana-Maria.Miron@nnkp.ro

A. General Information

According to the National Statistics Institute, Romania's GDP stood at roughly 230 billion lei (almost 66 billion euros) in the first nine months of the year, registering a 7.8% rise as compared to the same period in 2005. The most significant growth rate of 8.3 percent was reported in the third quarter of 2006.

Economic experts say that consumption also stands at high levels, with a significant contribution to economic growth. Others believe it is the introduction of the 16 percent flat tax in early 2005 that underlies all these economic developments. Some western pundits say that Romania's national currency, the Leu, has appreciated in 2006 more than any other European currency, becoming the most dynamic in the world. The Leu might continue its appreciation, as foreign investment could double, with the country's EU accession, on January 1st, 2007.

However, according to the new EU8+2 Regular Economic Report, GDP growth strengthened in Romania in 2006, but is likely to ease in 2007. Moreover, World Bank specialists believe that 2007 will bring another round of regulated price increases for most EU8+2 countries, with the impact on inflation likely to be most pronounced in Hungary, the Czech Republic, Estonia, Lithuania, and, to some extent in Romania. At the same time, the recent sharp decline in oil prices could help dampen inflationary pressures in 2007.

The region's fiscal policies were generally pro-cyclical in 2006, and the picture is not likely to change much in 2007, as per the World Bank specialists.

B. Corporate income taxation

1. Which are the taxable entities?

The following persons are liable to pay Romanian corporate income tax:

- a) Romanian legal persons;
- b) foreign legal persons that carry out activity through a permanent establishment in Romania;
- c) foreign legal persons and non-resident natural persons that carry out activity in Romania through an association lacking legal personality;
- d) foreign legal persons incurring incomes from/or in connection with immovable property located in Romania or from the sale-assignment of participation titles in a Romanian legal person;
- e) resident natural persons associated with Romanian legal persons, for incomes incurred both in Romania and abroad, through associations lacking legal personality.

The Tax Code expressly exempts from the payment of the corporate income tax certain entities / institutions, such as:

- the state treasury;
- the public institutions, with respect to the public funds;
- the micro-enterprises (these pay a tax on turnover);
- the religious cults, in general;
- the accredited /authorized private education institutions, with respect to the revenues utilized for education activities purposes;
- the Fund for the guarantee of bank deposits, constituted according to law;
- the Fund for the investors indemnification;
- the Fund for the guarantee of private pensions;
- the National Bank of Romania;
- the ownership associations in certain cases;
- the not-for-profit organizations with respect to certain categories of incomes and with respect to the revenues incurred out of economic activities up to the ceiling of EUR 15,000/year.

2. How is the taxable income determined?

The taxable profit is to be computed as the **difference** between **incomes** incurred from any source and **expenses** made for the purpose of incurring taxable incomes during a given fiscal year, from which **non-taxable incomes** are deducted and to which **non-deductible expenses** are added.

In determining the taxable profit, other elements similar to incomes (such as the reserves for which deductions were previously taken) and expenses (such as the foreign exchange expenses resulted from the revaluation of the receivables / liabilities recorded as retained earnings from applying IAS for the first time) must be taken into account.

With respect to depreciable assets, the depreciation rates will be treated as deductible expenses and not the acquisition price paid in this respect.

Currently the taxpayers may record separately the accounting depreciation and the tax depreciation.

The depreciation methods available are: straight line (i.e. equal monthly installments during the useful life of the asset), digressive (in this case the depreciation is computed by applying a coefficient between 1.5 and 2.5 to the straight-line depreciation rates, depending on the useful life of the asset) and accelerated (50% of the asset value depreciated during first 12 months of utilization, while the rest is spread in equal monthly installments during the remaining useful life).

3. What are the applicable tax rates?

The general profit tax rate applicable to taxable profit is 16%.

The taxpayers performing entertainment activities such as those related to night-clubs, disco, casinos, sport bets for which the related profit tax would not exceed 5% of their similar revenues, then they must pay a 5% tax applied to these revenues (this would be a turnover tax).

4. Are capital gains taxed separately?

The capital gains are not taxed separately in case incurred by companies, but they are included into the taxable incomes and subject to the corporate income tax (i.e. taxed as business profits).

5. May losses be carried back or forward and to what extent?

Generally, yearly fiscal losses may be recovered from the taxable profits obtained during the following five consecutive years. The recovery of losses shall be made in the same chronological sequence as they were recorded.

The Romanian Tax Code does not envisage the tax losses carry back concept.

6. Are there any withholding taxes and at which rates?

The following types of income derived from Romania by non-residents are subject to the general 16% withholding tax:

- dividends
- interest
- royalties
- capital gains
- service fees (provided services are effectively performed in Romania)
- consulting and management fees (irrespective of their place of supply).

The gambling gains are subject to a 20% withholding tax.

With respect to dividend distributions, such are exempted from any withholding tax in case made to a foreign or Romanian company owning at least 15% (10% starting 2009) of the payer for a period of at least 2 years prior to the payment date (the Parent Subsidiary Directive principles transposed in the Romanian legislation).

In case that similar criteria are cumulatively met (i.e. minimum holding of 25% of the payer for a period of at least 2 years prior to the payment date), then the interest and royalty payments are

subject to a reduced withholding tax rate of 10% until 2011, starting when they will be fully exempted from the Romanian withholding tax.

The domestic withholding tax rate may be reduced or even eliminated in cases when a treaty for the avoidance of double taxation applies, provided that a certificate of fiscal residence is made available, in original, by the person claiming the benefits of the tax treaty. Please see Appendix 2 for the list of tax treaties concluded by Romania.

7. Are there any preferential group taxation rules in force?

There is no tax consolidation available for corporate income tax purposes. Starting with January 2007 the Romanian Tax Code introduced the “Fiscal Group” concept, but only for VAT purposes. However, to the best of our knowledge, presently, this concept was not tested yet in practice.

8. Which are the anti-avoidance rules currently in force?

Under the provisions of the Tax Code, the transactions between related parties must be carried on according to the arm’s length principle (i.e. transactions should be performed at the same price levels as those which could be reasonably expected from transactions conducted between non-related parties).

The holding threshold relevant in order to determine that the parties are related is of 25%.

The Tax Code further mentions that for transactions performed between related parties, the fiscal 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 reassessment does not affect the financials of the Romanian company (but only the tax position) and would not be applied in case the transactions between the related parties are performed on an arm’s length basis.

Thus, in respect of intra-group financing transactions, the transfer pricing regulation should be observed as well with regard to the interest rate level.

The Romanian legislation does not address the issue of controlled foreign corporations.

From a corporate income tax perspective, under the current Romanian’s thin capitalization rules, there are certain restrictions on the deductibility of interest expenses and the related foreign exchange losses. Generally, interest and foreign exchange expenses incurred by companies in relation to loans obtained from other entities than banks and financial institutions are subject to the following limitations:

- i) **Debt-equity ratio:** Interest expenses are deductible only if the debt-equity ratio is maximum 3:1. In case such ratio is higher than the aforementioned limit, or is a negative value, interest expenses are non-deductible for corporate income tax purposes and can be carried forward until they are fully deductible under the same conditions. Also, the difference between foreign exchange losses and foreign exchange revenues relating to long-term loans is treated as interest expense and is subject to the debt-equity ratio limitation.
- ii) **Interest rate:** Interest rate related to loans granted by companies other than financial institutions is deductible within the limit of a specific annual interest rate for loans

denominated in foreign currencies. The annual interest rate applicable for 2007 has not been published yet (the rate valid for 2006 was of 6%). Note that the interest rate test adjustment should be made prior to the debt-equity ratio test.

9. Which are the main administrative requirements to comply with the local tax authorities?

The current compliance requirements imposed by the law in respect of corporate income tax refer to the following:

- Quarterly submission of certain tax return(s) containing, among others taxes due, the quarterly corporate income tax due;
- Mid-year submission of financial statements;
- Yearly submission of financial statements;
- Yearly submission of corporate income tax return.

10. With which countries have double taxation conventions already been concluded?

Romania has an extensive network of countries with which double taxation treaties have been concluded (i.e. over 75 countries), such as: USA, UK, France, Spain, Germany, The Netherlands, Cyprus, Luxembourg, Finland, Denmark, Sweden, Malta, Poland, Israel, Turkey etc. (see Appendix 2).

11. Are there any special laws providing tax incentives to certain taxable entities?

Generally, the corporate income tax incentives regulated by past special legislation (i.e. foreign investments, significant investment of major impact, disfavored areas, free zones etc.) are, in principle, no longer applicable.

However, on a case by case basis analysis it could be determined if there are instances where former tax incentives would still be available. For example, according to the Tax Code, the taxpayers which have obtained, prior to July 1st, 2003, the permanent certificate of investor in a disfavored area will benefit of the corporate profit tax exemption related to new investments until the disfavored area will cease to exist.

Another incentive is provided in relation to the National Company “Nuclearelectrica” SA, which is exempted from the payment of the corporate income tax by December 31, 2010, to the extent the profit incurred is utilized for the purpose of financing the investment works for the Nuclear-electric power station Cernavoda – Unit 2, according to law.

C. Individuals

1. Which are the taxable persons?

The following categories of individuals are subject to income tax in Romania:

- a) resident natural persons;

- b) non-resident natural persons who carry out independent activities through a fixed base in Romania;
- c) non-resident natural persons who carry out dependent activity in Romania;
- d) non-resident natural persons who obtain other incomes.

2. How is the taxable income specified?

The categories of incomes that are subject to the income tax as provided by the law are the following:

- a) incomes from independent activities;
- b) incomes from salaries;
- c) incomes from the grant of the use of goods;
- d) incomes from investments;
- e) incomes from pensions;
- f) incomes from agricultural activities;
- g) incomes from prizes and from gambling;
- h) income from the transfer of immovable properties;
- i) incomes from other sources.

The taxable income shall be determined according to the rules provided by each category of income aforementioned.

3. What are the applicable tax rates?

Generally, the income tax rate is of 16% applied to the taxable income, except for the following:

- a) incomes from investments (i.e. please see answer to *Question 4* below);
- b) incomes from prizes and from gambling (i.e. 16%, 20% or 25% depending on the recurrence and the amount gained);
- c) incomes from the transfer of immovable properties (1%, 2% or 3% depending on the value of the property; it is applied to the property's value, not to the gain realized).

4. Are capital gains taxed separately?

In Romania, the capital gains incurred by natural persons – tax residents in Romania, and which are subject to taxation in Romania, are taxed separately, as they belong to the taxable income category of “investment incomes”.

Below is a table containing the relevant tax rates:

Income from investments	Non-residents		Residents	
	Rate	Comments	Rate	Comments

Shares held in closed companies and shares held in limited liabilities companies	16%	Based on the relevant certificate of fiscal residence, rate decreased or eliminated in accordance with relevant tax treaty	16%	-
Shares held in open companies	1%	Domestic rate applies in case of holding exceeding 365 days. Based on the relevant certificate of fiscal residence, rate decreased or eliminated in accordance with relevant tax treaty.	1%	Holdings exceeding 365 days
	16%	Domestic rate applies in case of holding less than 365 days. Based on the relevant certificate of fiscal residence, rate decreased or eliminated in accordance with relevant tax treaty.	16%	Holdings less than 365 days
Dividends	16%	Based on the relevant certificate of fiscal residence, rate decreased or eliminated in accordance with relevant tax treaty.	16%	-
Interest	16%		16%	-
Royalties	16%		16%	-

5. May losses be carried forward or back?

No. The Romanian legislation in force does not envisage the carry forward or carry back losses concepts in relation to the incomes incurred by individuals.

D. Capital

1. In outline, which are the main taxes on capital, if any?

Beside the tax payable in relation to the real estate sale, the Romanian legislation does not provide for specific taxes on capital (the stamp duties in this respect were eliminated starting January 1st, 2007).

E. Indirect taxes

In outline, which are the main indirect taxes, if any?

The main indirect taxes are VAT and excise duties. Starting January 1, 2007 the new VAT system in Romania was implemented based on the principles set out in the VIth EU Directive on the harmonization of the laws of the Member States relating to turnover taxes. In addition, the Romanian VAT transposed the provisions of the 8th Directive and 13th EU Directive on VAT refunds to EU and non-EU taxable persons.

The Romanian Tax Code provides a regular VAT rate of 19% and a reduced one of 9%, applicable for certain specific activities.

F. Other duties

In outline, are there any other taxes, if any?

Besides the taxes enumerated above, other taxes levied in Romania are:

- Local taxes (municipality taxes):
 - building tax:
 - natural persons pay 0.1% of the taxable value of the buildings, such being established based on certain criteria indicated by law; in case several buildings are owned, the local tax is increased by 15% - 100% for each subsequent property; in case of dwellings exceeding a built area of 150sq.m., the local tax is increased as well by 5% for each 50 sq.m. or fraction thereof;
 - legal persons pay 0.25% - 1.5% of net book value, or between 5% - 10% in case the respective building was not revalued during 3 prior consecutive years;
 - land tax (fixed amount per sq.m. established based on certain criteria);
 - transportation means tax (fixed amount depending on cylindrical capacity of vehicle);
 - certificates, approvals and authorizations tax (depending on surface or on value of investment, or fixed fees);
 - advertising tax (between 1% - 3% of contractual value);
 - outdoor publicity tax (fixed fee depending on place/dimension)
 - hotel tax (0.5% - 5% of tariffs levied);
 - show tax (between 2% - 5% of tickets sold or fixed amount per sq.m.)

Starting with January 1, 2007, for investments exceeding EUR 500,000 made by legal persons, certain incentives related to the tax on buildings / land may be granted by local councils for a period of up to 5 years.

Special tax for vehicles, levied for vehicles registered for the first time in Romania. The tax is calculated based on a special formula whose elements are represented by the cylindrical capacity and certain adjustment coefficients.

G. Enforcement- Litigation procedure

1. In outline, which are the existing measures in order to ensure compliance with the tax legislation?

In order to ensure the compliance with the tax litigations, the tax authorities are empowered to conduct tax audits.

The bar time for claiming taxes and special contributions to various state budgets is of five years, starting January 1st of the year following the year during which the tax obligation was born (except for cases of fraud, when the bar time is ten years). During this time interval, the tax

authorities may verify the calculation, recording and payment of taxes and contributions. Once a tax audit has been completed and adjustments, where applicable, were made by tax inspectors, the respective tax year is considered as closed for further audits. However, in some cases (e.g. litigation in progress, tax evasion, supplementary information that the tax authorities become aware of) a tax audit can cover periods already assessed in other tax audit reports.

2. What is on average the duration of the litigation?

A tax dispute generally undergoes two degrees of jurisdictions.

Note that the duration of a litigation procedure for the final resolution of tax disputes may vary significantly from case to case. However, please note that such procedure usually lasts not less than one calendar year.

APPENDIX**INCOME TAX RATES**

Corporations	Partnerships	Individuals	Other entities
Note that Romanian Tax Code provides for a flat tax rate of 16% , however, applied to taxable basis which are determined differently for corporations vs. individuals.			

LIST OF TAX TREATIES CONCLUDED BY ROMANIA

Country	Interest withholding tax rate	Royalties withholding tax rate	Dividends withholding tax rate
Albania	10	15	10 (at least 25% holding)/15
Algeria	15	15	15
Armenia	10	10	5(at least 25% holding)/10
Austria (new)	3/0 (for bank loans or loans concluded for more than 2 years)	3	0 (at least 25% holding)/5
Australia	10	10	5 (at least 10% holding)/15
Azerbaijan	8	10	5 (at least 25% holding)/10
Bangladesh	10	10	10 (at least 10% holding) 15
Belgium	10	5	5(at least 25% holding)/15
Belarus	10	15	10
Bulgaria	15	15	10 (at least 25% holding)/15
Canada	10	5/10(depending of royalties nature)	10 (at least 25% holding)/15
Costa Rica	10	10	5 (at least 10% holding)/15
Croatia	10	10	5
China	10	7	10
Czech Republic	7	10	10
Cyprus	10	5	10/0 (if paid from

Country	Interest withholding tax rate	Royalties withholding tax rate	Dividends withholding tax rate
			Cyprus)
Denmark	10	10	10 (at least 25% holding)/15
Ecuador	10	10	15
Egypt	15	15	10
Estonia	10	10	10
Finland	5	2.5/5 (depending of royalties nature)	5
France	10	10	10
FYROM	5	10	10
Georgia	10	5	8
Germany	0	3	5 (at least 10% holding)/15
Greece	10	5/7	45 (if paid from Greece) 20(if paid from Romania)
Hungary	15	10	5 (at least 40% holding)/15
India	15	22.5	15 (at least 25% holding)/ 20
Indonesia	12.5	12.5/15(depending of royalties nature)	12.5 at least 25% holding)/15
Israel	10/5 (depending on interests nature)	10	15
Italy	10	10	10
Ireland	3/0 (sale on credit of certain goods/beneficiary is a financial institution)/loans concluded for more than 2 years	3	3
Japan	10	10/15 (industrial royalties)	10
Jordan	12.5	15	15
Kazakhstan	10	10	10
Kuwait	1	20	1
Lebanon	5	5	5
Latvia	10	10	10
Lithuania	10	10	10

Country	Interest withholding tax rate	Royalties withholding tax rate	Dividends withholding tax rate
Luxembourg	10	0 (for bank loans)/10	5(at least 25% holding)/15
Malaysia	15/0(for interest related to long terms loans and paid from Malaysian)	12/0(if paid from Malaysia)	10/0 (if paid from Malaysia)
Malta	5	5	5/30 (if paid from Malta)
Mexico	15	15	10
Moldova	10	10/15(depending on royalties nature)	10
Morocco	10	10	15
Namibia	15	15	15
Netherlands	0	0	0(at least 25% holding)/5 (holding between 10% and 25%)/15
Nigeria	12.5	12.5	12.5
North Korea	10	10	10
Norway	10	10	10
Pakistan	10	12.5	10
Philippines	10/15 (depending on interests nature)	10/15/25 (depending on royalties nature)	10(at least 25% holding)/15
Poland	10	10	5 (at least 25% holding)/15
Portugal	10	10	10(at least 25% holding)/15
Russia	15	10	15
Singapore	5	5	5/0 (for profits distributed by a resident of Singapore)
Slovakia	10	10/15(depending on royalties nature)	10
Slovenia	5	5	5
South Africa	15	15	15
South Korea	10	7/10(depending on royalties nature)	7(at least 25% holding)/10
Spain	10	10	10(at least 25% holding)/15
Sri Lanka	10	10	12.5
Sudan	10	10	15
Sweden	10	10	10

Country	Interest withholding tax rate	Royalties withholding tax rate	Dividends withholding tax rate
Switzerland	10	0	10
Syria	7.5	10/15	0
Thailand	10 (beneficiary is a financial institution)/20 (for credit sale)/25	15	10 (for residents activating in certain fields and at least 25% holding)/20
Tunisia	10	11	12
Turkey	10	10	15
UAE	3	3/0(industrial royalties)	3
United Kingdom	10	10/15(industrial royalties)	10 (at least 25% holding)/15
Ukraine	10	10/15 (depending on royalties nature)	10(at least 25% holding)/15
United States	10	10/15 (industrial royalties)	10
Uzbekistan	10	10	10
Vietnam	10	15	15
Yugoslavia	10	10	10
Zambia	10	15	10