# Tax implications in public procurement in Romania

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Date: 14 March 2013

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## Scenario under analysis:

A Spanish construction company mainly focused on public constructions (water treatment plants, roads, etc) intends to tender in public construction projects in Romania.

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# *Options to carry out the activity in Romania*

Series of options for carrying out its activities in Romania:

•directly;

•via an unincorporated joint venture with another Spanish company or with a Romanian partner;

•via a Romanian branch; or

•via a Romanian limited liability company.

Key aspects to be taken into account when deciding on an option above:

•the amplitude and duration of the business the Spanish considers to develop in Romania, i.e. if only one single or few projects are intended to be carried out, or more projects;

•the time frame for repatriating profits/recovering losses; and

•the employment of the experts – if the Spanish company wants to use its specialists (from Spain) or wants to hire local experts.

Please note that subsequent to being awarded a project as a result of a public tender **it is rather difficult to change the legal structure** under which the activities would be carried out in Romania.

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# The Spanish company operates directly in Romania

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# *The Spanish company operates directly in Romania*

**Corporate Income Tax**

•The Spanish company will owe 16% corporate income tax in Romania only on the activities carried out therein that give rise to a permanent establishment (“PE”) in Romania.

•Under the Romanian Fiscal Code, the profit attributable to the PE is determined by treating the PE as a separate entity from its Spanish headquarters and applying the transfer pricing rules.

•Under the Romanian – Spanish DTT, the Spanish company should be entitled to benefit from a tax credit in Spain in respect of the corporate income tax paid in Romania on the taxable profits attributable to the Romanian PE.

•The PE would need to prepare financial statements according to the Romanian accounting rules.

•The Spanish company will not need to have any kind of legal registration in Romania (such as a branch), as the PE would require only a registration for tax purposes.

•The tax registration can be done in a single step, for both corporate income tax and VAT purposes (if required).

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## *The Spanish company operates directly in Romania*

**Value Added Tax**

•Due to carrying out services relating to immovable property located in Romania, the Romanian PE of the Spanish company would need to register for Romanian VAT purposes therein and issue invoices bearing 24% Romanian VAT to the public authority (beneficiary of the services) in respect of the services supplied.

•If the Spanish company performs more projects in Romania which will be subject to Romanian VAT, the Spanish company should be required to obtain one single registration number for VAT purposes (as opposed to the corporate income tax, where separate tax registration is required for each project generating a Romanian PE).

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# *The Spanish company operates directly in Romania*

**Distribution of dividends / Repatriation of profits**

•The profits earned by the Spanish company via the PE are available for distribution immediately and **free of any Romanian dividend tax**, as they do not qualify as dividends. Only corporate income tax should be paid in Romania for the profits allocated.

**Exit scenario**

•Once the construction project of the Spanish company in Romania would be completed, the Spanish companies could either sell asset-by-asset the PE or the PE as a whole. In either case, **from a corporate income tax perspective** under the Romanian Fiscal Code corroborated with the provisions of the Romanian – Spanish DTT, the sale of the assets of the Romanian permanent establishment would be subject to tax at 16% in Romania for the Spanish company, by inclusion of the capital gain in the taxable revenues of the seller attributable to the Romanian PE.

•**From an administrative point of view**, once the sale is completed, the Spanish company would just need to de-register the permanent establishment from the tax authorities.

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**The Spanish company operates via an unincorporated joint venture with a Spanish partner (“UTE”)**

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## *The Spanish company operates via an unincorporated joint venture with a Spanish partner ("UTE")*

- Any foreign entity that carries out economic activities in Romania as member of an unincorporated joint venture is treated as **subject to corporate income tax in Romania at 16%** for its share of the profits of the joint venture related to the activities carried out in Romania.

- The corporate income tax falling due in Romania could be eliminated by applying the Romanian – Spanish DTT under article 7 as long as the activities of the Spanish company performed within the joint venture agreement qualify as business profits, while a valid tax residency certificate is made available.

- However, please note that if the activities carried out in Romania by Spanish company through the joint venture give rise to a PE of the Spanish company therein, such PE would need to register and pay 16% corporate income tax in Romania, as commented in the section above.

## *The Spanish company operates via an unincorporated joint venture with a Spanish partner ("UTE")*

Administrative obligations for joint ventures formed exclusively of foreign companies to designate one of the two foreign parties (a leader) to fulfil the following obligations are set:

- register the joint venture for corporate income tax purposes, before the joint venture starts its activity in Romania;
- keep the accounting books of the joint venture, declare (quarterly and annually) and pay the corporate income tax in the name of each of the members of the joint venture at the legal deadlines;
- file a distinct declaration, also on a quarterly basis, by 25th of the first month of each quarter in respect of the previous quarter, to inform the tax authorities of the share of profits or losses distributed to each member of the joint venture, as well as the amount of corporate income tax paid on behalf of each member of the joint venture;
- supply information in writing to each member of the joint venture on their allocated share of revenues and expenses, as well as on the tax paid on their behalf.

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## *The Spanish company operates via an unincorporated joint venture with a Spanish partner ("UTE")*

**Value added tax**

•Although the joint venture is not a separate legal entity, it is regarded, from the point of view of the customer, as a single supplier of services, since the customer normally has the right to hold each and any of the joint venture members accountable for meeting the obligations undertaken under the contract.

•The Romanian Fiscal Code implicitly requires that only one set of invoices is issued to the customer in respect of the services rendered by the joint venture, while splitting the invoices between the members of the joint venture is normally not allowed. Under the Romanian VAT rules, joint ventures are not regarded as separate taxable persons, but the lead partner is required to take over all VAT rights and obligations derived from the activity of the joint venture.

•Thus, the lead partner of the joint venture needs to obtain a Romanian VAT number (different than the one obtained for itself in Romania due to carrying out activities independently therein – if applicable).

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## *The Spanish company operates via an unincorporated joint venture with a Spanish partner ("UTE")*

### Distribution of dividends / Repatriation of profits

•The profits earned by each member of the joint venture are proportionate with their participation in the joint venture and are not subject to dividend tax as they do not qualify as dividends.

### Exit scenario

•When terminating the joint venture agreement there are no significant tax implications arising therein. The only tax implications would arise further to the sale of the assets owned by the joint venture – i.e., corporate income tax on the profit obtained further to the sale and probably VAT if sold locally in Romania to the extent they apply.

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**The Spanish company operates via an unincorporated joint venture with a partner being a Romanian legal entity**

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## *The Spanish company operates via an unincorporated joint venture with a partner being a Romanian legal entity*

- The only significant difference between operating in Romania via an unincorporated joint venture with a non-resident (e.g., with a Spanish partner) or via an unincorporated joint venture with a Romanian partner is that when one of the parties of the joint venture is a Romanian resident legal entity, **all administrative obligations rest with the Romanian party**.

- As in this case the leader of the unincorporated joint venture would be the Romanian partner, at least from an administrative perspective, it should be noted that all invoices issued and received as well as payments should be made via the Romanian company.

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## *The Spanish company operates via an unincorporated joint venture with a partner being a Romanian legal entity*

**Value Added Tax**

•In this case all rights and liabilities of the joint venture will be undertaken by the Romanian partner (e.g., the Romanian partner would need to issue all invoices to the beneficiary on behalf of the joint venture, would need to issue all the invoices to the beneficiary on behalf of the joint venture, would need to submit the VAT return, pay or claim back the VAT to/from the state budget, etc).

**Distribution of dividends / Repatriation of profits**

•The profits earned by each member of the joint venture are proportionate with their participation in the joint venture and are not subject to dividend tax as they do not qualify as dividends.

**Exit scenario**

•When terminating the joint venture agreement there are no significant tax implications arising therein. The only tax implications would arise further to the sale of the assets owned by the joint venture – i.e., corporate income tax on the profit obtained further to the sale and probably VAT if sold locally in Romania, to the extent they apply.

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# The Spanish company operates in Romania via a branch

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## *The Spanish company operates in Romania via a branch*

**Corporate income tax**

•From a corporate income tax perspective, please note that if the Spanish company operates in Romania via a branch, this would qualify as a permanent establishment and thus the taxable profits derived from the activity of the branch would be subject to corporate income tax in Romania at 16%. The taxable profits shall be computed applying the transfer pricing rules as well as the other tax deductibility rules.

•We note that if operating via a branch, the Spanish company would be deemed to give rise to PE's in Romania for each of the projects carried out therein which triggers the obligation to register for corporate income tax purposes each of the PE while any tax position of all Romanian PEs cannot be consolidated (i.e. it is not possible to offset the tax losses against the profits realised among the PEs of the Spanish company), thus a tax and cash-flow problem may arise under this scenario.

•Tax losses of the branch can be offset against future tax profits to be offset against future tax profits to be obtained in the next 7 years in a row.

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## *The Spanish company operates in Romania via a branch*

**Value added tax**

•The same rules applicable to the case when the Spanish company operates directly in Romania.

**Distribution of dividends / Repatriation of profits**

•The same rules applicable to the case when the Spanish company operates directly in Romania.

**Exit scenario**

•The same rules applicable to the case when the Spanish company operates directly in Romania. In addition, please note that once the sale of the assets of the branch is completed, in this particular case the Spanish company would need to de-register the branch from the Romanian Trade Registry as well in addition to the tax deregistration from the tax authorities.

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**The Spanish company operates in Romania via a subsidiary**

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## *The Spanish company operates in Romania via a subsidiary*

**Corporate income tax:**

•As opposed to a branch, a subsidiary is subject to 16% corporate income tax in Romania on the worldwide income, as the subsidiary will in fact be a company incorporated in Romania and thus resident in Romania for tax purposes.

•Under this scenario any tax losses arising from the construction projects carried out in Romania can be both offset against profits obtained from other project and carried forward for a period of 7 years if the subsidiary is in an overall loss tax position.

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# *The Spanish company operates in Romania via a subsidiary*

**Value added tax**

•There are no significant differences in respect of VAT if the Spanish company operates in Romania via a subsidiary.

•The only difference concerns the transactions carried out with the Spanish parent company due to the fact that transactions carried out between a subsidiary and its parent company (as well as other companies within the group) will fall under the scope of VAT, as these would be actual deliveries of goods and services taking place between distinct legal entities.

•For the services carried out under the construction projects in Romania via a Romanian subsidiary, such subsidiary would need to register for VAT purposes therein and issue 24% Romanian VAT bearing invoices to the beneficiary of the services supplied under the project.

•If the Romanian subsidiary is used as a subcontractor of the Spanish company, please note that the Romanian company would need to charge 24% Romanian VAT to the Spanish parent for all construction type services carried out in respect of real estate located in Romania. Such 24% Romanian VAT would likely represent a cost at the level of the Spanish entity and may be recovered either by registration of the Spanish company in Romania for VAT purposes (if required by the law) or by applying the provisions of the 8th Directive and reclaiming the 24% Romanian VAT paid to the Romanian subsidiary back from the Romanian state budget – such a reclaim procedure may last however even up to one year in practice.

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## *The Spanish company operates in Romania via a subsidiary*

**Distribution of dividends / Repatriation of profits**

•Under the Romanian law, a subsidiary is allowed to distribute dividends to its parent company only after the shareholders' approval of the annual final financial statements.

•The profits which a subsidiary distributes to its EU parent companies should be exempt from Romanian withholding tax if the parent company holds a minimum of 10% of the shares of the subsidiary for an uninterrupted period of at least two years. Thus, dividends distributed by the Romanian wholly-owned subsidiary would be free of withholding tax in Romania only after a period of minimum shareholding of 2 years is met.

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# *The Spanish company operates in Romania via a subsidiary*

**Exit scenarios - Share deal**

•The sale of shares held in the Romanian subsidiary by the Spanish company would be subject to Romanian **capital gains tax at 16%** under the Romanian Fiscal Code.

• However, **the 16% tax could be eliminated under the Romanian – Spanish DTT** if the Spanish company provides a valid tax residency certificate issued by the relevant Spanish authorities.

•**The level of taxable capital gains** earned by the company would be the difference between the sale proceeds less fiscal value of the shares (e.g. the nominal value, the acquisition cost, including any acquisition-related commissions, fees, and taxes).

• **From a procedural perspective**, if the buyer of the shares is a nonresident, the obligation to pay the capital gains tax lies with the seller which needs to register directly or via a Romanian tax agent in order to fulfil its declarative obligations (i.e., file corporate income tax returns).

• However, if the shares are sold to a Romanian company or a Romanian permanent establishment of a non-resident company, the Spanish company would no longer need to register for corporate income tax purposes, as the obligation of withholding, declaring, and paying the related tax and/or keeping the valid certificate of tax residency shall lie with such a Romanian legal entity acting as buyer.

•No **VAT** implications should arise further to the sale of shares in the Romanian as under the currently applicable rules, the sale of shares is VAT exempt.

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# *The Spanish company operates in Romania via a subsidiary*

**Exit scenarios – asset deal**

•In an asset deal scenario, the profit resulting further to the sale of assets held by the Romanian subsidiary can be distributed as dividends to the Spanish company or as liquidation proceeds, as applicable.

•Please note that dividends can be distributed by a Romanian company only from annual realised profits, as stated in the Financial Statements approved by the General Shareholders' Meeting. No interim distributions of dividends are currently allowed.

•Dividends distributed by a Romanian company (e.g., the Romanian subsidiary) to EU companies (e.g., the Spanish company) are subject to withholding tax at 16% in Romania. In order to benefit from a more favourable treatment, the provisions of the DTT's concluded between Romania and the country of tax residency of the dividend income recipients can be invoked, provided a valid tax residency certificate is made available by the shareholder.

• However, no Romanian dividend tax shall be due under the EU Parent-Subsidiary Directive, as implemented in the Romanian Fiscal Code, if the dividends are paid after minimum two years of uninterrupted shareholding and the Spanish entity holds at least 10% of the share capital of the Romanian subsidiary. From a procedural perspective, in order to apply this dividend tax exemption, the dividends recipient shall present to the Romanian paying entity at the time of cashing the dividends an affidavit stating that the conditions laid down by the EU law are fulfilled at the date of the dividends' payment, along with its valid certificate of tax residency.

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## *The Spanish company operates in Romania via a subsidiary*

- In what concerns taxation of liquidation proceeds, please note that only the surplus in addition to the effective contribution to the share capital should be subject to Romanian 16% withholding tax; however, based on the tax residency certificate of the Spanish company, the Romanian withholding tax may be reduced to zero under the Romanian – Spanish DTT.
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- In what concerns the Romanian **VAT** implications, the sale assets held by the Romanian subsidiary would likely trigger 19% Romanian VAT as long as the assets remain in Romania. However, if the asset deal were made as a transfer of a going concern, the transaction would fall out of the VAT scope thus, not subject to Romanian VAT.

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# Thank you!

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