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Current tax implications of real estate transactions in Romania

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Overview

- Changes in VAT legislation affecting real estate transactions in 2008
- Taxation on exit – Asset deals vs. Share deals
- Dividends taxation – latest developments

Changes in VAT legislation

Elimination of VAT simplification measures

- In 2007, the provided the application of a reverse charge system on the following types of transactions carried out between entities registered for VAT purposes:
 - Sales of real estate (i.e. land, buildings or parts thereof); and
 - Construction works.
- The simplification measures mentioned above have been abolished as of 1 January 2008.



Elimination of VAT simplification measures

- **Effects of simplification measures under the previous legislation:**
 - Construction companies had little or no output VAT collected on their sales, so input VAT incurred had to be reclaimed directly from the state budget;
 - Constant VAT credit positions had put significant pressure on the cash-flows of construction companies, as VAT reclaims are usually lengthy processes and thus input VAT required extensive financing;
 - VAT simplification measures did present advantages to real estate developers and final beneficiaries of real estate projects, as VAT did no longer pose cash-flow and financing problems for them.



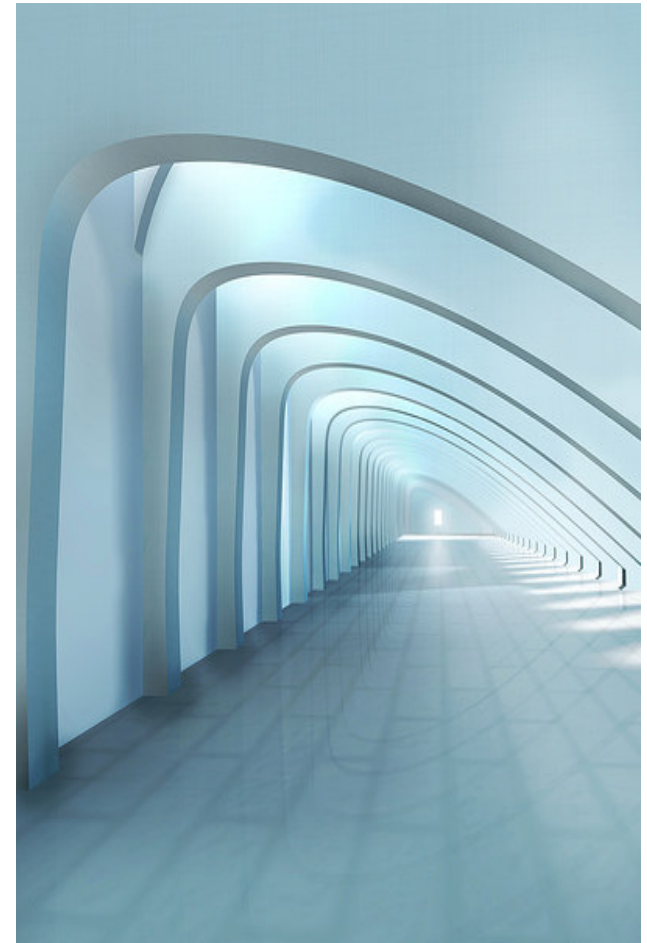
Elimination of VAT simplification measures

- **Effects of elimination of simplification measures as of 1 January 2008:**
 - Construction companies no longer have an input VAT financing issue;
 - The matter of financing the input VAT on real estate acquisitions has been shifted to final customers, as they now need to pay the acquisition price with VAT and offset / reclaim such input VAT later.



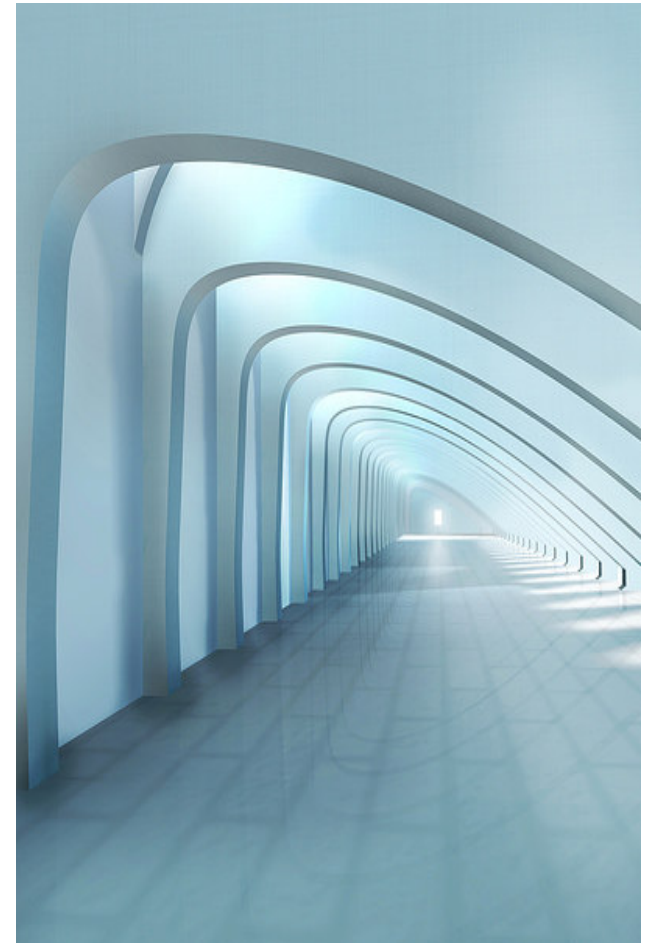
VAT on real estate transactions carried out by individuals

- **As of 1 January 2008, Romanian authorities started scrutinising real estate projects developed by individuals, from a VAT perspective.**
- Under the definition of the taxable person given by the Romanian Fiscal Code, anyone (including individuals) carrying out economic activities (i.e. activities with a certain degree of continuity and aimed at deriving profits) of an independent manner is seen as a taxable person from a VAT perspective and thus is required to collect VAT on its output transactions, where such VAT applies.



VAT regime of sales and rental of real estate

- **As of 1 January 2007, the VAT regime applicable to real estate transactions is as follows:**
 - Sale of new buildings and buildable land is subject to VAT at 19%;
 - Sale of old buildings and non-buildable land is by default exempt from VAT without credit for input tax, but the seller may opt to charge VAT on the sale;
 - Rental and leasing of real estate (irrespective whether it concerns new or old buildings) is by default exempt from VAT without credit for input tax, but the landlord/lessor may opt to charge VAT on such transactions.



Taxation of asset deals vs. share deals

Asset deals vs. share deals

- **Asset deals by Romanian companies holding real estate:**
 - **Capital gains** derived by a Romanian company from the sale of real estate assets are subject to corporate income tax at **16%** at the time of the sale;
 - Potential benefits may arise from **revaluations** of buildings prior to sale, as revaluations made after 1 January 2007 are taken into account for tax purposes. Revaluation reserves transferred to retained earnings at the time of the sale defer taxation until distributed as dividends, thus allowing companies to re-invest profits in new projects without having to pay tax first; Revaluation may also impact local taxes for buildings.
 - **Notary fees** fall due upon the transfer of ownership over the real estate.



Asset deals vs. share deals

- **Share deals**

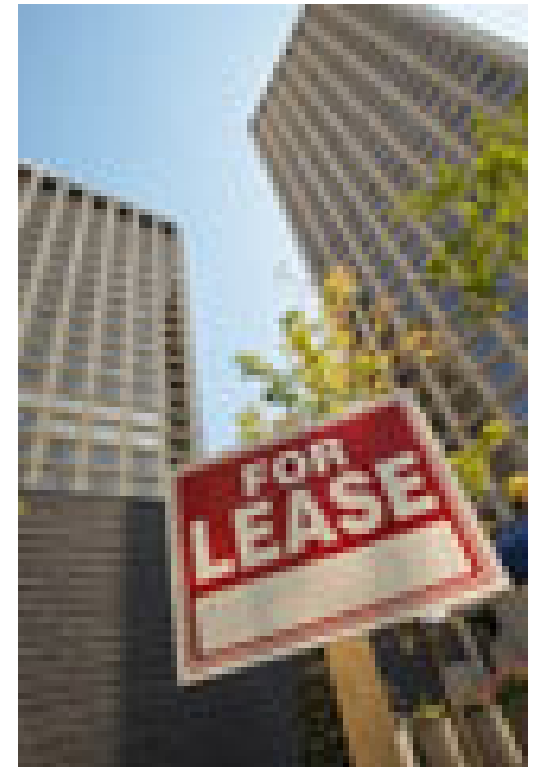
- Under the Fiscal Code, capital gains derived from the sale of shares in a Romanian real estate company are taxed in Romania (at 16%). However, some of Romania's Double Tax Treaties give taxation rights only to the country of the residence of the shareholder earning the gains and may optimise taxation;
- Shareholding structures are important in the context of real estate investments, as they determine taxation upon exit via a share deal, as well as the level of net profits after tax during the holding period;
- Notary fees are not an issue, as real estate does not change ownership further to share deals.



Latest developments in taxation of dividends

Latest developments in taxation of dividends

- As many investors in Romanian real estate are foreign companies or individuals choosing to invest via a Romanian special purpose vehicle, taxation of outbound dividends is important.
- Currently, the Romanian Fiscal Code provides a 10% tax rate for dividends distributed to Romanian corporate shareholders, compared to a (general) 16% tax rate for dividends distributed to foreign corporate shareholders. This has been recently challenged by the EU as a discriminatory practice infringing the EU and EEA Treaties, and according to recent press releases, the Romanian authorities intend to reduce the withholding tax rate for outbound dividends to 10% as well.
- Separately, the EU Parent Subsidiary Directive (exemption from dividend tax) applies with regard to EU corporate shareholding entities in given conditions (minimum 15% (10% from 2009) holding for minimum 2 years) and various Double Tax Treaties may also apply to reduce the tax rate on dividends.



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