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Key tax changes from 1 January 2007

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Corporate income tax

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- Maintenance of flat rate of 16% rate
- Harmonisation with the EU Directives, namely introduction of:
  - the EU "Merger Directive" allowing "tax neutral" mergers between companies resident in different EU member states
  - The EU "Parent-Subsidiary" Directive allowing exempt divided distribution to EU legal entities holding minimum 15% (10% starting 2009) of the shares of a Romanian company, for minimum 2 years

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Corporate income tax

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- Possibility to take into account, for tax purposes, the accounting revaluation of assets, effected after 1 January 2007 and the non-depreciated value of the assets revalued between 1 January 2004 and 31 December 2006
- Deductibility of certain expenses: e.g. specific reserves set-up by banks and other credit institutions will be disallowed, debt-equity ration not applicable for non-banking financial institutions; etc.
- Payment of profits tax – quarterly payments based on previous year profits tax, adjusted with the inflation – applicable for banks starting 1 January 2007 (and for all other companies starting 2008); annual profits tax return for taxpayers other than banks to be submitted by 15 April of the following year.

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Corporate income tax

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Transfer Pricing

- Domestic legislation recognises OECD methods:
- Not subject to review in 2007 for intra-country transactions between Romanian companies qualifying as related parties (minimum 25% common shareholding)
- APA and Advance Rulings possible under Fiscal Procedural Code
- Transfer pricing file required under Fiscal Procedural Code
- Further development; documentation requirements

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Micro-enterprises

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- Maintenance of micro-enterprises system of turnover taxation
- New tax rates applicable: 2% in 2007, 2.5% in 2008 and 3% in 2009
- New conditions for qualification as micro-enterprise (besides maximum turnover of 100,000 Euro per annum, between 1-9 employees, maximum 50% of turnover derived from consultancy activities).
- If one of the conditions is not fulfiled during the year (incl. during 2007), the microenterprise becomes a corporate income tax payer from the beginning of that year (profits tax payable from next quarter).

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Individual income taxation

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- Maintenance of the flat 16% rate (e.g. for salary income)
- Increased taxation (16%) of capital gains arising in transactions with privately held shares
- The 1% capital gains tax remains applicable for sale of shares held in listed companies, for minimum 1 year holding period
- Harmonisation with the EU Savings directive (taxation of interest derived by individuals)

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Individual income taxation

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New system of taxation of income arising from transactions with real estate: instead of the current taxation of the gains such derived at 16%, the new tax system will apply as follows:

- if the sale of land is performed within a period of 3 years from the moment of acquisition the applicable income tax is:
  - 3% applied to the sale value in case such value is less than RON 200,000 (equivalent of approx. EUR 57,000); or
  - RON 6,000 (approx. EUR 1,715) plus 2% applied to the amount exceeding RON 200,000.
- if the sale of land is performed after 3 years from the moment of acquisition, the applicable income tax is:
  - 2% applied to the sale value, should such value be less than RON 200,000; or
  - RON 4,000 (approx. EUR 1,150) plus 1% applied to the amount exceeding RON 200,000
- Elimination of stamp duties (e.g. on transactions with real estate)

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Withholding tax

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Romanian legislation (Fiscal Code)

Scope: withholding is generally levied on income of non-residents earned from Romania, in case the non-residents do not have a permanent establishment in Romania to which the incomes are attributable

Rates:

- Dividends: 16% (for non-resident individuals and companies)
- Interest: 16% (with certain exceptions)
- Royalties: 16%
- Services: 16%

Double tax treaties: prevail over domestic law, provided certificate of residency available (form conditions); cannot be invoked if the contract contains a net-of-tax clause

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Withholding tax

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Romanian legislation – dividends distribution (current rules)

Timing: - annual distribution of dividends by Romanian legal entities allowed, after approval of annual financial statements; no interim dividends allowed at present.

Taxation: - if paid to a Romanian legal entity - 10%

- if paid to a Romanian individual – 16%
- if paid to a non-resident entity or individual - 16% (under domestic law);
- if DTT applicable, a more favourable rate may apply under the DTT (e.g. 0% or 5% under the new DTT Romania-Austria)
- starting 2007: EU participation exemption (“Parent-Subsidiary” Directive) granted to the EU and Romanian legal entities, recipients of dividends, provided minimum 15% holding (10% starting 2009), for minimum 2 years ending at the time of payment of dividends

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Withholding tax

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- **Harmonisation with the EU “Parent-Subsidiary” Directive (taxation of dividends) – please refer above**
- **“Interest & Royalties” Directive to apply from 1 January 2011. In the transition period until 31 December 2010, a 10% domestic rate applies to payments made by Romanian entities to EU legal entities deriving interest and royalties from Romania, provided a minimum 25% shareholding for minimum 2 years ending at the time of payment of interest/royalties (unless a more favorable rate applies under the applicable DTT)**

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Local taxes
Stamp duties

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- **Local Taxes**
  - **New local tax rate (0.1%) for buildings owned by individuals (decreased from 0.2% for urban buildings; 0.1% stays for rural buildings).**
  - **New building tax rates for legal entities (0.25-1.5% instead of 0.5-1%) applicable on book value (between 5-10% for buildings not revalued in the past 3 years); improvements on leased buildings to be included in the taxable basis**
  - **In case of finance leases, the lessee is liable to pay the tax on the book value of the asset**
  - **Two bi-annual tax payments by 31 March / 30 September (instead of quarterly tax payments)**
  - **Certain exemptions from local tax may be granted by Local Councils**
- **Stamp duty** – elimination of stamp duty starting 1 January 2007

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Indirect tax

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- **The effect of Romania's EU accession will be reflected in the adoption of the ''*acquis communautaire*'', i.e. the set of directives, regulations, rules, court cases (of the European Court of Justice - ECJ) and practical solutions adopted already by EU member states**
- **Tax-wise, the most important effect of the EU accession will be reflected in the indirect tax implications of doing business in Romania, as a EU member state, i.e. with regard to value added tax (VAT) and customs duties**

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Indirect taxation

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EU Indirect tax Directives

- VAT 6th Council Directive (77/388/EEC), the 8th and 13th Directives;
- Excise directives (mainly Council Directive 92/12/EEC)
- EU Customs Code EEC Council Regulation 2913/92, Implementing EEC Commission Regulation no. 2454/93), Integrated Customs Tariff (common duty rates and preferential trading relationships) and other related EU Directives

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Indirect taxation

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- Main changes to <u>cross-border trading with goods and rendering of services</u>:
  - exports and imports of goods with non-EU member states
  - trade with EU member states
  - services to/from entities in EU member states or to/from non-EU member states
- Elimination of customs borders (creation of "Single Market"), but maintenance of VAT borders will result in implementation of new rules for place of delivery of goods/place of supply of services
- <u>Examples</u>: exports to non-EU member states will continue to be exempt from Romanian VAT, if the supplier has proof that the goods have left the enlarged EU; imports (i.e. goods are put into "free circulation") in the EU through Romania subject to VAT, but reverse-charge ("postponed accounting") mechanism will be applicable (and hence neutral from a cash-flow perspective – this was amended starting 15 April 2007 and cash payment of import VAT was reintroduced, with certain exceptions)

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Indirect taxation

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Main changes to domestic transactions and **intra-community trading with goods and rendering of services**:

- Free movement of goods intra-community: "imports" and "exports" replaced for intra-community trade by "intra-community acquisitions" (ICA) and "intra-community supplies" (ICS)
- Reporting of statistical data for intra-community trade via statistical reporting Intrastat (not via customs)
- Examples: ICA - no payment of VAT or customs duties as VAT reverse-charge applies in certain conditions; ICS – no VAT charged if proof of transport to another EU member state and VAT number of the customer are available to the supplier

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Indirect taxation

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Main changes to VAT legislation affecting real estate transactions

- Exemption from VAT, without credit for input VAT will apply to rental and leasing of real estate assets; the landlord/lessor has the option to tax the transaction (i.e. charge 19% VAT on the transaction and hence to have input VAT deduction right)
- Sale of new buildings and building land (specifically defined) taxable at 19%; the simplification rules for sale of real estate assets continue to apply, provided both the seller and the buyer are Romanian VAT payers (in this case, the reverse-charge mechanism applies, without cash-flow implications for both parties)
- Sale of buildings and land other than the ones noted above will be VAT exempt without credit for input VAT. However, the seller may opt to tax such transactions (i.e. charge 19% VAT) and thus gain deduction right for the input VAT incurred on the acquisition / construction.
- The adjustment period for real estate assets will be increased to 20 years (from the period of adjustment of 5 years applicable in 2006)
- Capital assets register (including real estate assets) to be maintained

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Indirect taxation

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Other changes to VAT legislation :

- new invoicing procedures (EU directive on simplifying VAT invoicing requirements); elimination of "fiscal invoices", introduction of electronic invoicing and third party invoicing
- commercial documentation and the changes to ERP systems to permit records regarding the customer's EU VAT numbers to determine VAT treatment, registration in the EU VAT Information Exchange System ("VIES"), classification of goods traded by 8-digit codes (similar to customs codes) for Intrastat reporting purposes, etc.
- new reporting, for example monthly/quarterly VAT return, VAT journals, quarterly EC Sales List and EC Purchase List ("recapitulative statements"), "Non-transfer" Register, Register of "Received goods", "Capital goods" Register
- possible foreign VAT registration requirements to be reviewed (e.g. in case of triangulation, distance sales, ICA in other member states)

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