

Transfer Pricing trends in Romania



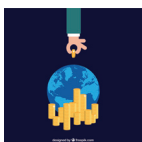
Introduction



For many years, transfer pricing was an area only known to a limited number of practitioners. Perceived as art, science or even magic, transfer pricing continues to be an important source of controversy between the tax authorities in various jurisdictions and multinational companies.



A whirlwind of international tax change has swept the globe in the past few years, and for tax executives in Europe, there is no end in sight. From broader requirements for tax transparency, through to more stringent transfer pricing policies to greater scrutiny of business substance, every country and every multinational company is feeling the impact.



The current dynamic of the global economy, in which intra-group transactions are growing, both in terms of volume and in their complexity, has led to increased focus by tax authorities and various international bodies (e.g. the Organization for Economic Cooperation and Development – OECD), on identifying new and more effective ways to protect the tax bases in each country. Measures to limit taxable base erosion and profit shifting have been drafted, and implemented, in certain jurisdictions, under the OECD's Coordinated Action Plan on Base Erosion and Profit Shifting ("BEPS").



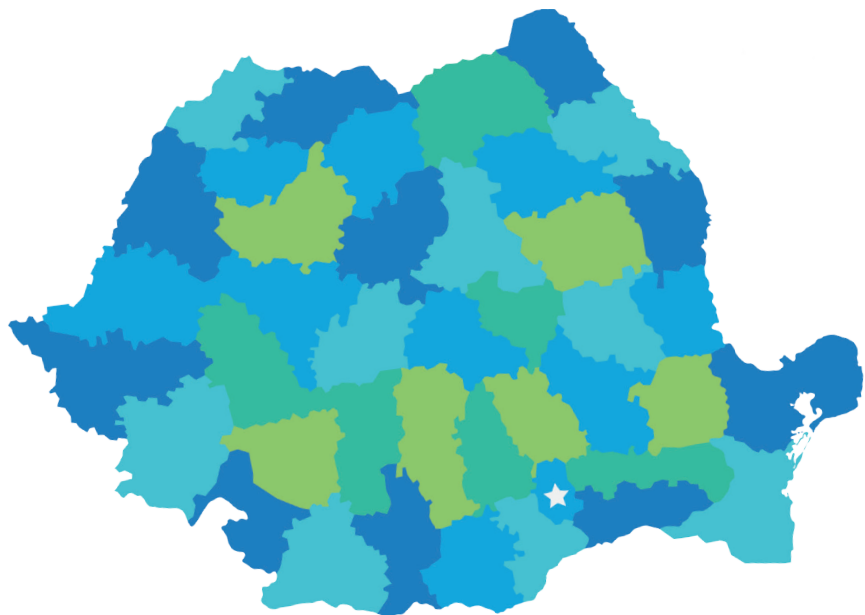
At the same time, tax authorities need to identify taxpayers and their intra-group transactions which present a risk of transfer pricing adjustments, in an accurate manner and with a high degree of confidence, to reduce expenditure and the allocation of resources. The objectives of the BEPS Action Plan are to release reports which "will give countries the tools they need to ensure that profits are taxed where economic activities generating profits are performed and where value is created, while at the same time giving business greater certainty by reducing disputes over the application of international tax rules and standardizing requirements"¹.



Under these circumstances, the need to observe transfer pricing principles and document the arm's length character of intra-group transactions has become essential for all multinational companies, which may need to allocate more resources to ensure they comply with the rules.

The purpose of this brochure is to present the current legal provisions on transfer pricing in Romania.

Romania – current and future transfer pricing environment



Within an international context of increased focus on taxable base erosion and profit shifting and, particularly, on transfer pricing, the Romanian tax authorities are playing their part and are increasingly vigilant in looking carefully at transactions carried out between entities of the same group of companies. They pay equal attention to both domestic and

cross border intra-group transactions.

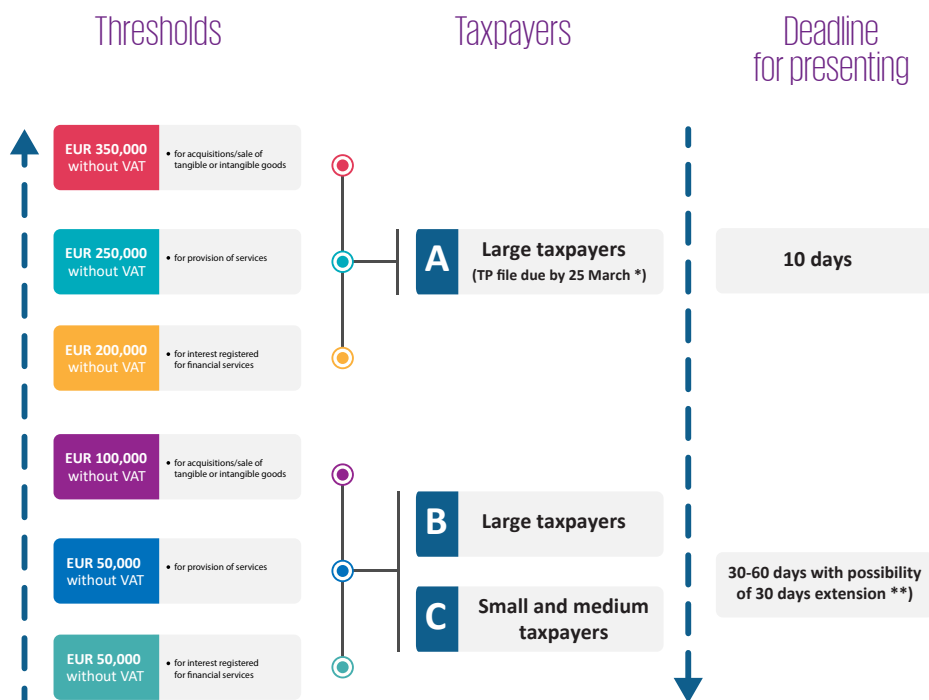
At the beginning of 2016, Order no. 442/2016 was issued by the Romanian Ministry of Finance, which made important amendments to Romanian transfer pricing legislation.

The Order sets thresholds for each category of taxpayer for the value of intra-group transactions,

above which taxpayers may be required to provide related transfer pricing documentation to the tax authorities demonstrating that these transactions have been carried out at market value. The Order also sets out rules on the content of the transfer pricing documentation, as well as the procedure for adjusting/estimating transfer prices.

The Romanian tax authorities are playing their part and are increasingly vigilant in looking carefully at transactions carried out between entities of the same group of companies.

The main requirements are illustrated in the table below



*) The deadline for submission of the corporate income tax return (D101) – usually 25 March for financial years ending 31 December .

**) from the date of receiving an official request from the Romanian tax authorities.

The content of the transfer pricing documentation file

Order 442/2016 updates the rules on the content of the transfer pricing documentation file, which should include two main sections:

- Group information, and
- Taxpayer specific information.

Group information



Group history and development

Structure of the group; Legal structure; Organizational and operational structure

General description of the group's activity; Group's main products and services; Group's main competitors; Group's main customers; Business strategy; Financial information

General description of the group's transfer pricing policy

General description of the transactions carried out between the group entities

General description of the function carried out, risks assumed and assets used by the related parties at a group level.

Presentation of the intangibles and their owners within the Group

General description of the transfer pricing policy established at the group's level with respect to the financial arrangements carried out

General description of potential restructuring activities within the group during the analyzed period

General description of the research and development activity carried out within the group



Taxpayer specific information

General description of the company

History

Structure of the Romanian company

General description of the activity carried out by the Romanian company; main products, main customers, main competitors, business strategy, description of the main markets for delivering goods/provision of services made by the company in relation to its related parties, financial indicators

General description of the research and development activity carried out by the company

General description of the transfer pricing policy established with respect to the financial transactions carried out by the company

Presentation of cost contribution arrangements concluded by the company

General description of the potential restructuring activities within the company in the analyzed period

Presentation of APAs available to the company in relation to intra-group transactions

Transfer pricing adjustments may be made by the tax authorities based on three independent transactions qualifying as similar to the one that is being analyzed.

Failure to comply with the transfer pricing documentation requirements is penalized by a fine which is currently between

RON 12,000 and RON 14,000
(approximately EUR 2,666
to EUR 3,111) for medium
and large taxpayers.

RON 2,000 and RON 3,500
(approximately EUR 444 to
EUR 777) for other taxpayers.

However, more serious consequences can arise if a company does not submit its transfer pricing documentation file to the authorities by the deadline, or if the file is incomplete, as in this case **the tax authorities are allowed to establish arm's length prices by their own means and adjust taxable profits**

accordingly for the audited period (16% tax will apply to the additional taxable profit plus related late payment penalties and interest). Transfer pricing adjustments may be made by the tax authorities based on three independent transactions qualifying as similar to the one that is being analyzed. A simple average is used.

Adjustments of intra-group transactions carried out between Romanian companies

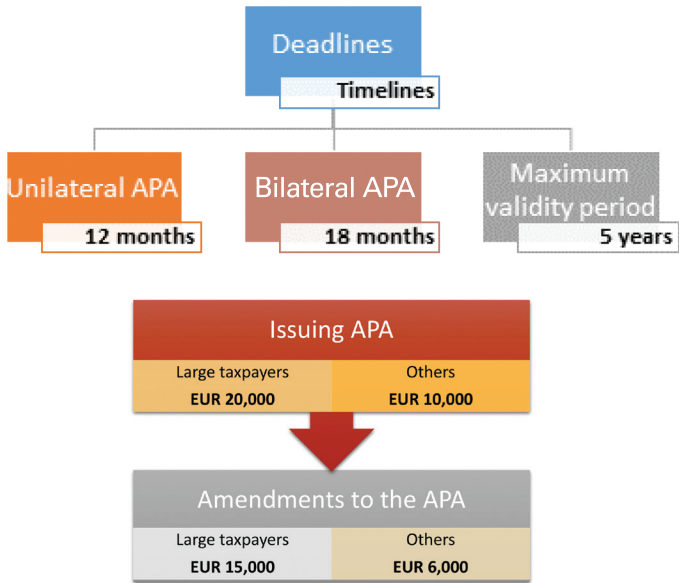
While much of the emphasis of stricter transfer pricing legislation has been on international intra-group transactions, the Romanian tax authorities have started to pay closer attention to transfer prices used domestically between Romanian related parties, as well. For example, the authorities want to make sure that profit is not artificially moved from profitable to non-profitable entities as a means of

reducing tax. The procedure for the tax authorities to make adjustments to transfer prices in domestic intra-group transactions was clarified under Order no. 3737/2015. Moreover, any adjustments made to domestic transactions between group entities may also lead to adjustments to international transactions involving further entities within the group located in other countries.

Advance Pricing Agreements

Current Romanian legislation allows taxpayers to obtain an APA ruling (Advance Pricing Agreement).

Advance Pricing Agreements (APAs) are tools through which companies obtain comfort on the pricing methodology used in relation to transactions carried out with group companies.



APAs are initiated by the taxpayer (one or more associated enterprises), which holds discussions with the tax authorities in one or more country, in advance of controlled transactions, to agree with the tax authorities on an appropriate set of criteria (e.g. method, comparable transactions / companies and appropriate adjustments thereto, critical assumptions as to future events) to determine the transfer prices for these transactions over a fixed period.

APAs are issued by tax authorities in many countries and can be split into unilateral APAs (applicable in only one country), bilateral APAs (two countries) and multilateral APAs (issued by the tax authorities in every country in which the group operates).

The main advantage of APAs is that they make it less likely that the tax authorities will adjust transfer prices in a subsequent audit.

Mutual Agreement Procedure (MAP)



Similar in certain respects to APA agreements (described above), the MAP procedure allows companies to request tax authorities from different countries to analyze intra-group transactions and make a joint decision as to how much tax is due in each of their jurisdictions, hence avoiding double taxation. The procedure is initiated simultaneously by the company in Romania and by the company in the other country, for the purpose of a reasonable allocation of profits between affiliated companies.

An official request should be submitted in Romania and the other country as well as related documentation/ explanations (the transfer pricing documentation file, the decision issued by the Romanian tax authorities, the fiscal report, etc.). The MAP procedure has been used in transfer pricing cases, and is increasingly included as a mechanism within Double Taxation Treaties (DTTs).

If two countries are not able to reach an agreement on the elimination of double taxation within two years, a special Arbitrage Procedure

is used. Recent Double Tax Treaties (“DTTs”) increasingly provide for this procedure following an unsuccessful MAP.

For European Union Member States, the legal framework for transfer pricing MAP cases is covered, in most cases, but not exclusively, by the **Arbitration Convention** (Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises).

For transfer pricing MAP cases with non EU-countries, the MAP provisions contained in the double taxation agreements concluded by Romania with other countries may apply. However, none of the double taxation agreements concluded by Romania with non-EU countries allow arbitration procedures, under the Arbitration Convention.



The automatic exchange of information²

On 9 June 2017, the Ministry of Public Finance published Emergency Ordinance no. 42/2017 for the purpose of transposing EU Directive 881/2016 on the mandatory automatic exchange of information on taxation, which is a follow-up to the recommendations of BEPS Action 13, issued by the OECD.

The main measures introduced are the following:

1. Reporting obligation

The provisions of the Ordinance apply only for groups with a consolidated income higher than the threshold of

EUR 750,000,000 in the year preceding the reporting fiscal year, which are required to make the country-by-country annual report.

The following multinational entities are required to submit an annual report for each country:

- Parent companies with fiscal residence in Romania.
- Any other reporting entity that meets the conditions specified in the law (i.e. if the Romanian company is appointed by the group as the reporting entity).



Companies that do not fulfill the criteria mentioned above (i.e. do not qualify as a parent company with fiscal residence in Romania and have not been appointed by the group as the reporting entity), but are part of groups with consolidated revenues over EUR 750,000,000, are required, under Article 7 of section II, to notify the appropriate authority in Romania as to the identity and fiscal residence of the reporting entity, no later than the last day of the fiscal year of reporting for the related group of multinational entities, and no later than the last day for submitting the corporate tax return of the related company for the previous fiscal year. The format for the notification which must be submitted was set out in Order 3049/2017.

2. Content of the report

The country-by-country report must include the following tax information: turnover, income / loss before corporate tax, income tax paid / accrued, declared capital, undistributed profit, number of employees and tangible fixed assets.

In addition, the report should contain details of the constituent entities of the group, such as: the jurisdiction of the tax residence and the main economic activities carried out.

3. The scope of reporting

The main aim of the tax authorities is to assess the risk of tax base erosion, as well as the risk of the transfer of profits from one jurisdiction to another.

The appropriate tax authority in Romania is required to send this report by automatic exchange of information to any other Member State in which one or more entities of the group have their tax residence or taxable economic activities through a permanent establishment. Similarly, the Romanian tax authorities will also receive the group's tax report from the authorities in other countries.

4. Effective date

The new reporting rules have been applied in Romania starting with the financial data for the fiscal year which started on 1 January 2016 (or after that date, in certain circumstances).

5. Deadlines for submission and penalties

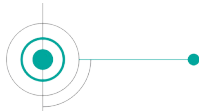
The reporting deadline for each country is 12 months from the last day of the reporting fiscal year of the group. Failure to submit the report within the time limit set by the draft legislation, or the sending of incomplete or incorrect information, results in penalties of between RON 30,000 and RON 50,000. Also, non-submission of the report may lead to penalties of between RON 70,000 and RON 100,000



Our services

The KPMG transfer pricing team has assisted various companies in preparation of their transfer pricing files. In many cases, these have later been subject to tax/transfer pricing audits, which have been finalized

without transfer pricing adjustments or with minimal adjustments. We have extensive experience in providing transfer pricing services such as:



Preparation of the transfer pricing report, as well as identification of main risk areas in terms of transfer pricing.



Update of the transfer pricing report.



Review of the transfer pricing documentation, in order to verify whether it is compliant with Romanian transfer pricing requirements.



Assistance during transfer pricing audits (holding meetings and discussions with the tax authorities, drafting appeals and explanatory notes, as well as providing various explanations, as requested).



Assistance in applying for an APA.



Planning of transfer pricing policy.



Assistance in applying for the MAP



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