

Law no. 227/2015 on the Fiscal Code, as later amended and expanded

ART. 7 - Definitions

26. *affiliated persons* - a person is affiliated if the relation between such person and another person is defined by at least one of the following cases:

a) a natural person is affiliated with another natural person if such persons are spouses or relatives up to the 3rd degree inclusive;

b) a person is affiliated with a legal person if the person owns, directly or indirectly, the holdings of the affiliated persons, representing minimum 25% of the value/number of the participation titles or of the voting rights held in the legal person, or if it actually controls the legal person;

c) a legal person is affiliated with another legal person if at least the former holds, directly or indirectly, the holdings of the affiliated persons, representing minimum 25% of the value/number of the participation titles or of the voting rights held in the other legal person, or if it actually controls the legal person;

d) a legal person is affiliated with another person if a person holds, directly or indirectly, the holdings of the affiliated persons inclusive, representing minimum 25% of the value/number of the participation titles or of the voting rights held in the other legal person or if it actually controls that person;

Between affiliated persons, the price for which the tangible and intangible assets are transferred or for which services are supplied represents a transfer price.

33. *market value principle* - when the conditions established or imposed in the trading or commercial relations between two affiliated persons are different from those that would have existed between independent persons, any profits which in the absence of those conditions would have been realized by one of the persons, but have not been realized by this person due to those conditions, may be included in the profits of that person and taxed accordingly;

ART. 36 - Tax result of a permanent establishment

(1) The foreign legal persons pursuing an activity through a permanent establishment in Romania shall have the obligation to pay the profit tax for the taxable profit which is attributable to the permanent establishment.

(2) The tax result shall be determined in accordance with the rules provided in Chapter II of this Title, under the following terms:

a) only the incomes which are attributable to the permanent establishment shall be taken into account for determining the tax result;

b) only the expenses which are effected for the purpose of obtaining such incomes shall be taken into account for determining the tax result.

(3) The tax result of a permanent establishment shall be determined by treating it as a separate person and by using the transfer price rules in order to establish the market value for the transfer between the foreign legal person and its permanent establishment. For the expenses which were allocated to the permanent establishment by its head office, the other documentary evidence must include proof regarding the actual coverage of the costs and the reasonable allotment of these costs to the permanent establishment by using the rules of the

transfer prices.

(4) In case that, before the end of a fiscal year, it is not determined whether the activities of a non-resident in Romania will be long enough to become a permanent establishment, the incomes and expenses of that fiscal year shall be considered in the next fiscal year, in case the legal duration of 6 months or the time limit provided in the convention on the avoidance of double taxation, as the case may be, are outdated. From the profit tax owed by the permanent establishment, since the beginning of the activity, amounts with withholding at source shall be deducted, if they were paid in the period before the registration of the permanent establishment, according to Title VI.

(5) In case that the foreign legal person carries on the activity in Romania only through one permanent establishment, this shall also be the permanent establishment designated to fulfil the obligations under this Title.

ART. 37 - Tax result of the foreign legal person that pursues its activity through several permanent establishments in Romania

(1) The foreign legal person that pursues its activity through several permanent establishments in Romania shall have the obligation to establish one of these offices as permanent establishment designated to fulfill its obligations under this Title. At the level of the designated permanent establishment the incomes, respectively the expenses, of the permanent establishments pertaining to the same foreign person shall be cumulated.

(2) The tax result of the foreign legal person that pursues its activity through several permanent establishments shall be determined at the level of the permanent establishment designated to fulfill its obligations under this Title, in accordance with the rules established in Chapter II, under the following conditions:

a) only the incomes that are attributable to each permanent establishment shall be transmitted to be cumulated by the permanent establishment designated to fulfill the fiscal obligations;

b) only the expenses incurred in order to obtain the incomes of each permanent establishment shall be transmitted to be cumulated by the permanent establishment designated to fulfill the fiscal obligations.

(3) The tax result at the level of the designated permanent establishment shall be determined on the basis of the incomes and expenses incurred by each permanent establishment belonging to the same foreign legal person, in compliance with paragraph (2), and by using the transfer pricing rules in determining the market price of a transfer made between the foreign legal person and its permanent establishment. For the expenses allocated by its head office, the other supporting evidence must include proof regarding the actual coverage of the costs and the reasonable allocation to the permanent establishment by using the rules of the transfer prices.

(4) The designated permanent establishment in Romania shall calculate, declare and pay the obligations under Title II, based on the incomes and expenses registered by all designated permanent establishments belonging to the same foreign entities.

(5) In case the fixed establishment that fulfils the fiscal obligations according to Title VI is also a permanent establishment for the purpose of Article 8, the fixed establishment shall also be the permanent establishment designated to fulfill its obligations under this Title.

GOVERNMENT DECISION No. 1/2016 of 6 January 2016 - Part I
on the approval of the Methodological Norms for the application of Law
no.227/2015 regarding the Fiscal Code

SECTION 2 – Rules for applying the arm's length principle

5. (1) In applying the provisions of art.11 par.(4) of the Fiscal Code, the most appropriate method of the following is used to adjust/estimate the price at arm's length of the transactions:

a) *comparable price method*, which is based on the comparison of the price of the analyzed transaction with the prices charged by other entities independent of it, when comparable products or services are sold. For the transfer of goods or services between affiliated persons, the price at arm's length is the price that would have been agreed by independent persons, under existing market conditions, which are commercially comparable, for the transfer of identical or similar goods or merchandise, in comparable quantities, at the same point in the production and distribution chain and under comparable delivery and payment conditions. For this purpose, in order to establish the market value, it is possible to make an internal comparison of the prices used by the concerned legal person in the transactions with independent persons or to make an external comparison of the prices used in the transactions between independent persons. When the quantities are not comparable, the sales price for identical or similar goods and services sold in different quantities shall be used. For this, the sale price is corrected by the extra or minus differences that could be determined by the difference in quantity;

b) *the cost plus method*, which is based on the increase of the main costs with a profit margin corresponding to the taxpayer's field of activity. The starting point for this method in the case of the transfer of goods, merchandise or services between affiliated persons is represented by the costs of the manufacturer or the service provider. These costs are determined using the same calculation method that the person making the transfer bases his/her pricing policy with independent persons. The amount added to the established cost will take into account a profit margin that is consistent with the taxpayer's business. In this case, the price at arm's length of the controlled transaction is the result of adding the profit to the cost. Where products, goods or services are transferred through a number of affiliated persons, this method is to be applied separately for each stage, taking into account the role and the actual activities of each affiliated person. The profit that increases the supplier's costs in a controlled transaction will be duly determined by reference to the profit margin used by an independent supplier in comparable transactions;

c) *the resale price method*, whereby the arm's length price is determined on the basis of the resale price of the products and services to independent entities, diminished by the distribution costs, other expenses of the taxpayer and a profit margin. This method is applied starting from the price at which a product purchased from an affiliate is resold to an independent person. This price is reduced by an appropriate gross margin, called the resale price margin, representing the value from which the last seller within the group covers its selling and other operating expenses according to the operations carried out, taking into account the assets used and the risk assumed, and make an appropriate profit. In this case, the price at arm's length for the transfer of the good between affiliated persons is the price remaining after the margin has been lowered and adjusted with other costs associated with the purchase of the product. The resale price of the last seller in a controlled transaction can

be determined by reference to the resale profit margin that the same ultimate seller earns on the goods purchased and sold in comparable uncontrolled transactions. It is also possible to use the profit margin of the last sale made by an independent person in comparable uncontrolled transactions. When determining the value of the resale price margin, the following must be considered:

- (i) factors relating to the time period between the initial and resale purchases, including those relating to changes in the market in terms of expenditure, exchange rates and inflation;
- (ii) changes in the condition and wear degree of the goods subject to the transaction, including changes in technological progress in a particular field;
- (iii) the resellers' exclusive right to sell certain goods or rights, which could influence the decision regarding a change in the price margin.

The resale price method is used when the reseller does not substantially increase the value of the product. The method may also be used when, prior to resale, the goods are insignificantly processed and, under these circumstances, the appropriate margin can be established;

d) *the transactional net margin method* involves calculating the net profit margin earned by a person as a result of one or more transactions with affiliated persons and estimating that margin on the basis of the level obtained by the same person in transactions with independent persons or on the basis of the margin obtained in comparable transactions by independent persons. The net margin approach involves a comparison between certain financial indicators of affiliated persons and the same indicators of independent persons operating within the same field of activity. In making the comparison, it is necessary to take into account the differences between persons whose margins are comparable, taking into account factors such as the competitiveness of people and equivalent goods on the market, the efficiency and management strategy, the market position, the difference in the structure costs, as well as the level of business experience;

(e) *the profit split method* refers to estimating the profits made by affiliated persons as a result of one or more transactions and dividing those profits among affiliated persons in proportion to the profit that would have been obtained by independent persons. This is used when transactions between affiliated persons are interdependent, so that comparable transactions can not be identified. Profit sharing must be achieved by an appropriate estimate of earnings and costs incurred as a result of one or more transactions by each person. Profits should be broken down to reflect the functions performed, the risks assumed and the assets used by each party;

f) any other method recognized by the Transfer Pricing Guidelines issued by the Organization for Economic Co-operation and Development for multinational companies and tax administrations, with subsequent amendments.

(2) When comparing the transactions between affiliated and independent persons, the following shall be considered:

a) differences due to the particularities of material, non-material goods or services, subject to the comparable transactions, to the extent that these particularities influence the price at arm's length of the subject of that transaction;

b) the functions performed by persons in the respective transactions.

(3) When analyzing the functions of participants in a transaction, the following shall be taken into account: the economic importance of the functions performed by each participant, the

sharing of risks and responsibilities among the parties involved in the transaction, the volume of committed resources, the machinery and the equipment, the value of the intangible assets used.

(4) One of the methods provided above shall be used when determining the price at arms's length of transactions between affiliated persons. In order to determine the most appropriate method, the following elements are to be considered:

- a) the approach which is most closely related to the circumstances in which prices subject to free competition are established in commercially comparable markets;
- b) the method for which data from the effective operation of affiliated persons involved in transactions subject to free competition are available;
- c) the degree of precision with which adjustments may be made to achieve comparability;
- d) the circumstances of the individual case;
- e) the activities actually carried out by the various affiliated persons;
- f) the method used must match to the market circumstances and the activity of the taxpayer;
- g) the documentation that can be provided by the taxpayer.

(5) The circumstances of the individual case to be considered in the examination of the price at arms's length are:

- a) the type, status, quality and degree of novelty of the goods, merchandises and services transferred;
- b) the market conditions on which goods, merchandises or services are used, consumed, processed or sold to independent persons;
- c) the activities and stages of the production and distribution chain of the involved entities;
- d) the clauses contained in the transfer agreements regarding: the obligations, the payment terms, the rebates, the discounts, the guarantees granted, the risk assumption;
- e) in the case of long-term transfer relationships, the benefits and risks associated with them;
- f) special conditions of competition.

(6) When applying the methods, the data and documents recorded when the contract was concluded are taken into account. In the case of long-term contracts, it is necessary to consider whether independent third parties take into account the associated risks by concluding the appropriate contracts.

(7) Specific financial arrangements shall be considered for the application of the methods, such as: payment terms or credit facilities for clients other than ordinary commercial practice. Also, in the case of customer supply of ancillary materials or services, these factors have to be taken into account when determining the price at arm's length.

(8) When applying the methods, we shall not consider the prices which have been influenced by special competitive situations, such as:

- a) prices on special closed markets, where such prices are set differently from the conditions on the market on which the transfer takes place;
- b) prices subject to special discounts in connection with the introduction of new products on the market;

c) prices that are influenced by the regulations of the public authorities.

(9) When determining the market value of services in transactions between related parties, the tax authorities shall first examine whether the independent persons, with appropriate conduct, would have concluded such a transaction under the conditions established by the affiliated persons, taking into account the common rates for each type of activity or the standard rates in certain areas such as transport, insurance. If there are no comparable rates, the “cost plus” method is used.

(10) In the case of advertising costs, they shall be deducted by those affiliated persons who are to benefit from the advertising made or, if necessary, allocated proportionally to the benefit. When calculating the tax result, the tax authorities estimate the costs incurred by affiliates with advertising, in proportion to the benefits earned by these persons from advertising.

If a taxpayer incurs advertising costs by which an affiliate benefits also, it is assumed that the first person provided the second person with commercial services in proportion to the nature and scope of the services provided by an independent advertising company. In order to establish more clearly the proportion of the expenses incurred by each person with the advertising by which two or more affiliated persons benefit, we shall take into account the markets the markets on which advertising was made and the market share of those affiliated persons in the sales of goods and services advertised. If the advertising costs are assumed by the parent company on behalf of the group as a whole, they are non-deductible for the affiliated person.

(11) When a taxpayer grants a loan/credit to an affiliated person or when he receives such a loan/credit, regardless of its purpose and destination, the arm’s length price for such a service is the interest that would have been agreed by independent persons for such services provided under comparable conditions, including the administration fee for the credit or the loan. In the case of funding services among affiliated persons, for the allocation of revenues is analyzed:

a) whether the loan is in the interest of the carrying out the beneficiary’s activity and has been used for that purpose;

b) if there was a profit distribution scheme.

The classification of the loan in the profit distribution scheme will be made if, at the date of the loan, no reimbursement of the loan is clearly expected or the contract contains unfavorable clauses for the payer.

When analyzing interest expenses/revenues, we must take into account: the amount and duration of the loan, the nature and purpose of the loan, the guarantee involved, the currency involved, the foreign exchange risk and the costs of foreign exchange rate insurance measures and other circumstances of granting the loan.

The reporting of loan terms shall take into account the interest rates applied in comparable circumstances and in the same currency area by an independent person. Also, we should take into account the measures that independent persons would have taken to share foreign exchange risk, for example: clauses that maintain the value of the loan in real terms, the conclusion of a foreign exchange hedge or the payment at the expense of the lender.

In the case of interest rates regarding suppliers of goods and services, it is necessary to examine whether the cost of interest is an ordinary commercial practice or whether the parties to the transaction demand interest where, in comparable transactions, the goods and services are transferred to each other. These elements of analysis are also considered for other forms

of income or costs assimilated to interest.

(12) When determining the market value of intellectual property rights in transactions among affiliated persons, the tax authorities examine first whether independent persons with appropriate conduct would have concluded such a transaction under the conditions established by affiliated persons.

In the case of the transfer of intellectual property rights, such as patent rights, licenses, know-how and the like, the costs of using the property are not deducted separately if the rights are transferred in connection with the supply of goods or services and if included in their price.

(13) In the case of administration and management within the group, the following are to be considered:

(a) among affiliated persons, the costs of administration, management, control, consulting or similar functions are deducted at central or regional level through the parent company on behalf of the group as a whole. No remuneration may be required for these activities, to the extent that their legal basis is the legal relationship governing the form of business organization or any other norms establishing links between entities. Expenditures of this nature may be deducted only if such entities provide in addition services to affiliated persons or if in the price of goods and in the value of the services provided are taken into consideration also the services or administrative costs. No such costs can be deducted by a subsidiary which uses these services, taking into account the legal relationship between them, only on their own terms, taking into account that they would not have used those services if they were an independent person;

b) services must be provided in fact/actually provided. The mere existence of services within a group is not sufficient, as, as a general rule, independent persons only pay for services that were actually provided.

(14) The adjustment/estimation of the records, carried out by the fiscal authority in order to reflect the principle of arm's length value of the products, goods and services, is also made at the other affiliated person.

For the adjustments/estimates made between affiliated Romanian persons, the procedure for the elimination of double taxation between affiliated Romanian persons is also applied, according to Law no. 207/2015 on the Fiscal Procedure Code, and for the adjustments/estimates made between Romanian affiliated persons and non-residents, the mutual agreement procedure established according to the Fiscal Procedure Code applies.

(15) Adjustment/Estimation of the transfer prices, in order to reflect the arm's length principle in transactions between persons of the goods, merchandise or services provided, that are subject to the transaction, shall be performed by the tax inspection authority at the level of the central market trend. The central market trend shall be considered to be the median value of the comparison interval of the comparable financial indicators of the identified comparable companies/transactions or, in the case that there are not enough comparable companies/transactions in order to establish a comparability interval, at most three comparable companies or transactions shall be identified and the arithmetic mean of their financial indicators or identified transactions shall be used.