

ROMANIA

TRANSFER PRICING COUNTRY PROFILE

1. Reference to the Arm's Length Principle

The arm's length principle was introduced in the domestic tax law in 1994 and is applicable to all related party transactions, including those taking place between a non-resident legal entity and its Romanian permanent establishment. Starting with 2010, related party transactions carried out between two Romanian legal entities also fall within the scope of transfer pricing investigations, whereas previously only transactions with non-resident related parties were investigated by the tax authority.

Art. 19 of the Romanian Fiscal code (Law no. 571/2003, as amended) establishes the general rule that transactions between related persons or entities must be valued at normal market value, i.e. value that would have been agreed on by independent parties. In order to determine the normal market value, the circumstances of related party transactions should be compared with the circumstances of comparable transactions carried out between independent persons or entities. In case such differences are met, that cannot be properly explained or documented by the audited taxpayer, it may be concluded that transfer prices are not set at arm's length and the tax authorities can adjust the taxpayers' revenues and expenses so as to reflect the market value. Currently, this approach applies both in purely domestic and in cross-border situations.

2. Reference to the OECD Transfer Pricing Guidelines

Although Romania is not a member of the OECD, domestic legislation expressly stipulates that in the application of transfer pricing rules, the Romanian tax authorities will also consider the OECD Transfer Pricing Guidelines.

3. Definition of related parties

According to art. 7 point 21 of the Fiscal Code, two legal entities are related parties provided that:

- one entity holds directly or indirectly (through the shareholding of related entities) a minimum of 25% of the number/value of shares or voting rights in the other entity or it effectively controls the other entity; and
- one entity holds directly or indirectly (through the shareholding of related entities) a minimum of 25% of the number/value of shares or voting rights in the two entities.

A natural person is a related party with a legal entity provided that he/she holds directly or indirectly, including the shareholding of related entities, a minimum of 25% of the number/value of shares or voting rights in the legal entity or it effectively controls the legal entity). Two natural persons are related parties provided that they are spouses or relatives up to the third degree.

4. Transfer pricing methods

Domestic legislation provides that taxpayers may use traditional transfer pricing methods (comparable uncontrolled price, cost plus and resale price), as well as any other method that is in line with the OECD Guidelines (transactional net margin and profit split). Also, national legislation gives priority to transaction-based methods over profit-based methods, and specifically states the hierarchy in selecting the appropriate transfer pricing method. Therefore, it is explicitly mentioned that, if the comparable uncontrolled price or any other traditional transfer pricing method cannot be used, the taxpayer should justify in the documentation the reasons for not doing so.

5. Transfer pricing documentation requirements

In line with the Fiscal procedure code (Government Ordinance no. 92/2003, as amended), taxpayers engaged in related party transactions are required to prepare a transfer pricing file that needs to be presented, upon request of the tax authorities, during a tax audit. The deadline is to be set at maximum three months from the date of receiving the formal written request, with the possibility of a single extension with a period equal to the term initially established. The tax audit may be suspended until the transfer price file is made available.

In 2008, detailed regulations regarding the content of the transfer pricing file were published (Order no. 222/2008 on the content of the transfer pricing file). The provisions of Order no. 222/2008 are in line with OECD Guidelines and Code of Conduct on Transfer Pricing Documentation Associated Enterprises in the European Union (EU TPD), published in the Official Journal of the European Union No. C176/1 of 28th of July 2006.

Generally, the transfer price file shall include *information about the group* (legal, operational and organizational structure, general description of group's activity, business strategies, transfer pricing methodology at group level, overview on the transactions between related parties, intangible assets' holders within the group, general description of functions and risks assumed by the related parties, etc.), *information about the audited taxpayer* (detailed presentation of controlled transactions, functional analysis, contractual terms, economic circumstances, specific business strategies, use of internal or external comparables, documented description of the transfer pricing method), *description of other conditions deemed relevant for the taxpayer*.

There is currently no minimum threshold for documenting controlled transactions or any simplified documentation rules and, therefore the Romanian tax authorities can investigate the arm's length nature of any controlled transaction.

6. Specific transfer pricing audit procedures and / or specific transfer pricing penalties

Burden of proof

The primary burden of proof is on the taxpayer, by way of the transfer pricing documentation that needs to be prepared according to national legislation requirements. On the other hand, where a transfer pricing file is not presented, upon request, the tax authority is likely to assume that transactions are not at arm's length and impose adequate corrections to the taxable income. Also, in the event the prices applied in a transaction with a related party are challenged, the tax administration should determine the market value based on the available information on similar transactions.

Statute of limitation

Profit adjustments on transactions between related parties can be performed within the domestic statute of limitation period of 5 years. By means of exception, the right to assess tax obligations shall be limited to 10 years, provided that such obligations are likely to result from fiscal fraud, falling under the provisions of criminal law.

Desk and field audits

Generally, the procedural rules for transfer pricing audits are the same as those applicable to ordinary examinations. The audits are initiated by a notification sent to the taxpayer, which will detail the nature and scope of the audit. The audit is closed by issuing a draft report that the taxpayers may oppose. After preliminary hearings granted to the taxpayer, the tax auditors may issue the final report, which can include adjustments.

Similar to ordinary tax audits, the transfer pricing audit might be initiated by selecting taxpayers as audit targets, based on various data, such as:

- significant related parties transactions;
- consistent losses;
- payment of minimal taxes;
- taxpayers' past behaviour: compliant or non compliant etc.

The formal request for transfer pricing file is generally preceded by preliminary inquiries into related parties' transactions, such as requests for inter-company agreements or explanations of related parties' transactions as disclosed in the financial statements or accounting documents.

Penalties

Failure to present the transfer pricing file may result:

- in fines ranging from LEI12,000 up to LEI14,000 (i.e. approx EUR2,700 to EUR3,000 at the current foreign exchange rate); and
- in estimation of transfer prices by the tax authorities based on generally available information on similar transactions, as the arithmetic mean of prices on three similar transactions; the additional taxable profits resulting from this estimation or any transfer pricing adjustments are subject to the general 16% profit tax rate and corresponding late payment interest and penalties.

Under Romanian legislation, interest and penalties in case of late payment are non-deductible.

7. Information for Small and Medium Enterprises on TP

Currently, there are no specific transfer pricing rules and regulations or simplified procedures for small and medium size enterprises.

8. Information on dispute resolution

Currently, the domestic legislation foresees two possible forms of Mutual Agreement Procedures (MAPs):

- MAPs, as provided by bilateral tax treaties concluded by Romania with other countries; and
- MAPs under the EU Arbitration Convention for EU Member States.

Dispute resolution under the Arbitration Convention does not need to be initiated and may be suspended if one of the enterprises involved is subject to a "serious penalty" for the transactions giving rise to the profit adjustment (Article 8).

The declaration of Romania on the definition of "serious penalty" (*Official Journal L 174, 03/07/2008 P. 0001 – 0005*) is:

"The term 'serious penalty' includes the commission of any criminal act provided by the tax evasion law or the accountancy law or the company law or the tax legislation. It also includes administrative penalties in regard to:

- *refusal to submit the tax statements (declarations) or the informative statements at the request of the tax bodies;*
- *refusal to supply documents and records requested by the tax inspection authorities;*
- *failing to submit the periodical financial documents and the accounting reports or, submitting such documents or reports which include incorrect data;*
- *actions included in the tax record, according to the legislation in force."*

The taxpayer can request a mutual agreement procedure based on tax treaty, if the treaty provides for a MAP. In accordance with the OECD Model Tax Convention and EU Arbitration Convention, the MAP can be initiated at the taxpayer request, within 3 years from the first notification of the action resulting in double taxation. The negotiations are conducted through competent authority channels and the taxpayer will not be party to the MAP. Also, the arbitration clause may not be invoked, if the bilateral tax treaty does not contain such provisions. The payment of tax and interests will not be suspended by the MAP. The authority to which a MAP request may be addressed is the Romanian National Agency for Fiscal Administration.

9. Relevant regulations on Advance Pricing Arrangements

Taxpayers engaged in related party transactions have the option to apply for advance pricing agreements (APAs).

The APA is defined as an administrative act issued by the tax authority in the view of addressing a taxpayers' formal request in the scope of establishing the conditions and methodology to set up transfer prices in related party transactions for a determined period of time.

The procedure is initiated by the taxpayer through the submission of a formal request for an APA that can be preceded, if requested by the taxpayer, by a pre-filing meeting with the tax authority representatives. The content of documentation that needs to be provided for issuing an APA is similar to the content of the transfer pricing file, only it refers to future controlled transactions.

APAs can be unilateral, bilateral or multilateral and may be issued for a period of up to 5 years. By means of exception, its validity may be longer in case of long-term agreements.

The APA is opposable and binding on the tax authorities as long as its terms and conditions are fully observed by the taxpayer. Also, it is mandatory for the taxpayer to submit an annual report detailing on the fulfilment of the terms and conditions of the agreement, by the deadline for submitting the statutory financial statements.

If a taxpayer does not agree with the APA, a notification may be sent to the issuing tax authority, within 15 days from the communication date and the APA will no longer produce legal effects. The deadline for issuing APAs is 12 months in case of unilateral APAs and 18 months in case of bilateral or multilateral APAs. In case of large taxpayers and for transactions included in the agreement with an annual consolidated value exceeding EUR4 million, a fee of EUR20,000 is to be paid, whereas for amending it the fee amounts to EUR15,000. For the rest of the taxpayers (small and medium size enterprises), the fee for issuing an APA is EUR10,000, and the fee for amending it is EUR6,000.

Details regarding the application procedure and the documentation that needs to be prepared by a taxpayer intending to request an APA are provided in Government Decision no. 529/2007.

10. Links to relevant government websites/European Union/OECD

Romanian Government: www.gov.ro

Ministry of Public Finance: www.mfp.ro

Romanian National Agency for Fiscal Administration: www.anaf.ro

European Commission: www.ec.europa.eu

Organisation for Economic Co-operation and Development (OECD) – www.oecd.org

11. Other relevant information

Secondary and compensating year-end adjustments may result in double taxation. Two questionnaires launched by the EU Joint Transfer Pricing Forum (JTPF) in 2011 took stock of the situation prevailing in each EU Member State with respect to secondary and compensating year-end adjustments as on 1 July 2011.

Safe harbour rules

In case of inter-company loans, the deductible interest expenses shall be limited to:

- the level of the reference interest rate of the National Bank of Romania which corresponds to the last month of the quarter, for loans denominated in national currency; and
- the level of an annual interest rate, for loans denominated in foreign currency (i.e. 9%); the level of interest rate for loans denominated in foreign currency is updated through Government Decision.

Thin capitalisation rules

Interest expenses on inter-company loans are deductible, provided that the debt to equity ratio is lower than or equal to three. In case the debt to equity ratio is negative or higher than three, interest expenses are non-deductible in the current year and can be carried forward to subsequent years, until their full deductibility.

The debt to equity ratio is determined as a ratio between the company's related party liabilities with a maturity exceeding one year (including liabilities whose maturity was extended so that it exceeds one year) and the owner's equity, by considering the average of the book values recorded at the beginning and at the end of the year.

This limitation is not applicable to banks, Romanian legal entities or branches of foreign banks, leasing companies for their leasing operations, real estate mortgage companies, credit institutions and non-banking financial institutions.