Romania

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General

1. What are recent tax developments in your country which are relevant for M&A deals?

Starting January 2016 a new fiscal code entered into force in Romania.

Amongst the changes brought by the new code, certain amendments relevant for mergers and acquisitions (M&A) were implemented in the field of corporate income tax (CIT) and value added tax (VAT). Specifically, stricter conditions shall apply starting 2016 in order for a partial spin-off to qualify as neutral for direct tax purposes, while from a VAT point of view it is provided that mergers and spin-offs are by default outside the VAT scope (with no additional condition to be met, as it was the case up to 31 December 2015).

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

So far, no specific action regarding the implementation of OECD BEPS action Plan 6 was taken in the domestic legislation. However, the Romanian tax law already contained general anti-abuse provisions.

For example, the fiscal code provides that cross-border transactions that are qualified as artificial by tax authorities would not enjoy the benefits of double tax treaties. Artificial cross-border transactions are those transactions lacking economic content and which cannot be normally used within usual business practices, their essential purpose being the tax avoidance or obtaining tax benefits that would otherwise not be granted.

Regarding domestic and EU cross-border M&A deals, they may not enjoy tax neutrality if they result in fraud and tax evasion detected according to the law.

Separately, Romania transposed in its domestic tax law the amendments brought by EU Directives 86/2014 and 121/2015 to EU Parent-Subsidiary Directive on (i) refraining from taxing the profits received by the Romanian parent company only to the extent they are not deductible for the subsidiary and (ii) regarding the fact that the exemption shall not be granted in case of an arrangement or series of arrangements which are not genuine and have the main purpose or one of the main purposes that of obtaining tax advantage.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

Share deal

Under a share deal in Romania the buyer takes over all liabilities, including tax liabilities, of the seller. Therefore buyers should perform in-depth due diligence to quantify the potential risks and eventually protect themselves with a share purchase agreement (by asking the seller for guarantees and indemnities if certain risks or liabilities do occur or become effective after the acquisition date).

A share deal does not affect the target company's depreciation plan for non-current assets, as the target is entitled to continue the depreciation plan applicable before the transaction.

No Romanian VAT applies, as transfers of shares are exempt without credit operations from a VAT perspective.

No Romanian stamp duties or other indirect taxes apply on sale of shares. However, potential notary fees may be due if the parties agree to notarise (authenticate) the share purchase agreement. In such a case the notary fees are owed either by the seller or by the buyer, as contractually agreed between the two parties.

The tax value of the shares is the acquisition price paid by the buyer. The tax value of the shares is used to determine the capital gains tax owed by the buyer in the case of a future share deal, if the specific exemption does not apply – see question 15.

The target is entitled to recover its fiscal losses within the legal deadline to carry forward the fiscal losses (i.e. 7 consecutive years; the recovery has to be performed based on FIFO method). It should be noted that special rules apply in case the target has to shift to the taxation system applicable to micro-enterprises (one of the conditions required to qualify as a micro-enterprise is to obtain yearly revenues below €100,000).

No real estate tax implications arise in the case of a share deal, as far as the assets of the target are concerned.

The buyer should implement a flexible structure to obtain efficient flows of dividends, borrowings, interest payments, royalties, and management services, while also considering implications for a future exit.

Asset deal

In an asset deal the buyer does not take over the seller's pre-closing financial and tax liabilities.

For Romanian tax purposes, the useful life of depreciable assets is established by a Government Decision as a range depending on the category of the non-current assets concerned. The general rule is that the taxpayer has the option to choose any period falling within the legal range.

Under an asset deal, the buyer is entitled to recover the acquisition price of the depreciable non-current assets during their remaining useful life via tax depreciation charges. The applicable VAT rate depends on the nature of assets transferred. In 2016 the standard VAT rate dropped from 24% to 20% (it shall be further decreased to 19% starting 2017).

Any input VAT incurred upon acquisition of assets may be asked for reimbursement by the buyer. However, such a procedure may prove to be administrative burdensome and lengthy (3 to 6 months or may be even longer depending on the complexity of operations, as it generally entails a tax audit). In case of specific operations, VAT simplification measures apply if the seller and buyer are both registered for VAT purposes in Romania. Examples of operations are sales of buildings and land. The simplification measures provide that the buyer accounts for VAT via reverse charge mechanism (both as input and output VAT) without any VAT cash-flow effect to the extent it has full VAT deduction right. If the asset deal qualifies as a transfer of a going concern, no Romanian VAT should apply because the transfer of a going concern falls outside of the Romanian VAT scope.

In an asset deal the target's fiscal loss cannot be used by the buyer, but may be off-set by the target against potential gains arising at the date of the asset deal.

No stamp duties, real estate tax or notary fees are due at the moment of the asset deal, except for cases where the transfer of the ownership legal title is authenticated by a public notary, when notary fees become due. Transfer of the ownership of land and buildings is generally mandatory to be authenticated by a notary public. The notary fees are owed either by the seller or by the buyer, as mutually agreed.

If the assets sold constitute real estate, vehicles or other assets for which local tax is due to the city hall, certain procedural requirements must also be fulfilled by both the seller and the buyer. In addition, if buildings are transferred, the related real estate tax to be owed by the buyer could differ from the real estate tax that was owed by the seller.

Starting 2016, the buildings are charged with different local tax rates depending on their destination (residential vs. non-residential). If the buyer is a legal entity, the taxable base for the first 3 years will be represented by the acquisition cost. Building's value should be updated based on a valuation report prepared by an authorised valuator at least once in every three years, as otherwise the tax rate will increase.

When a building is sold during a fiscal year, the building tax continues being due by the seller for the remaining period of that calendar year. The buyer owes build tax starting the next year (following the acquisition).

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

The value of the tangible and intangible assets in a share deal cannot be stepped up at the date of the share deal. However at the year-end, the value of the tangible non-current assets can be increased for both accounting and tax purposes further to a revaluation of the respective assets, provided that the target's accounting policy is to

revaluate its depreciable non-current assets. Nevertheless, the increased tax depreciation corresponding to the revaluation surplus is netted-off by an equal taxable item for CIT purposes. Recognition of a step-up in value of intangible assets for accounting and tax purposes is not allowed.

5. What are the particular rules of depreciation of goodwill in your country?

Goodwill cannot be depreciated for tax purposes.

For accounting purposes, according to the Romanian accounting regulations in line with the EU IV Directive, goodwill usually occurs upon consolidation and represents the difference between the purchase price and the fair value of the net assets acquired by an entity at the transaction date. However under these accounting rules, recognition of goodwill in the standalone financial statements is also allowed if the goodwill arises further to a total or partial transfer of assets and liabilities, irrespective of whether the transfer takes place within a normal sale or a merger process.

If the goodwill is recognised as an asset, it can be depreciated for accounting purposes, during a maximum 5-year period. However entities may depreciate goodwill systematically over a period longer than 5 years, provided that this period does not exceed 10 years, and it is disclosed and justified in the explanatory notes to the annual financial statements.

6. Are there any limitations to the deductibility of interest on borrowings?

According to general rule, expenses (including interest expenses) are deductible if they are incurred for business purposes.

In addition, the deductibility of interest expenses on loans borrowed from entities other than banks, leasing entities or other credit institutions (as listed by the Romanian fiscal code) is limited for each loan to the following thresholds:

- For loans denominated in foreign currency, the interest rate limit is 4% p.a. This interest rate limitation is revised periodically by Government decision, and therefore the 4% cap may change in the following years, including 2016;
- For loans denominated in Romanian currency (i.e. RON) the interest rate limit is the reference interest rate communicated by the National Bank of Romania for the last month of each reporting quarter (the Bank's reference interest rate valid in December 2015 was of 1.75% p.a.).

Should the interest rate on such loans exceed the indicated thresholds, the interest expense corresponding to the interest rate percentage in excess of the deductibility limitation would be non-deductible for corporate income tax purposes. The interest rate limitation test must be performed prior to applying the debt-to-equity ratio limitations (thin capitalisation rules) described below.

A second limitation on the deductibility of interest expenses and foreign exchange losses related to qualifying loans is the thin capitalisation rule which applies only in case of long-term loans. If the specific debt-to-equity ratio exceeds 3:1, or the equity records a negative value, interest expenses and net foreign exchange losses related to long-term qualifying loans are not deductible for corporate income tax purposes in the fiscal year concerned, but may be carried forward to be deducted in future financial years, as soon as the debt-to-equity ratio is positive and below 3:1. The debt-to-equity ratio is calculated as the ratio between the average qualifying debt and the average equity for the year concerned.

Qualifying debt refers to credit or loan defined for this purpose as any agreement between the parties that generates for one of the parties the obligation to pay interest and to repay the borrowed capital. However, for determining the debt/equity ratio, also non-interest bearing loans should be considered, if entered for a period of more than one year.

In addition, if the debt is received from a related party, transfer pricing provisions should also be observed and applied with priority over the interest rate deductibility limitation and thin capitalisation rules.

7. What are usual strategies to push-down the debt on acquisitions?

Although it is not very common in Romania, one way to push-down debt related to the acquisition of a Romanian target company is to use a leveraged buyout structure. Under a leveraged buyout, the main tax issue is the deductibility of the interest expenses related to the debt used to acquire the shares.

Under a leveraged buyout a Romanian Special Purpose Vehicle (SPV) is used to buy the target's shares. Subsequently the SPV and the target are merged and, hence, the debt obtained to acquire the target's shares is presented in the resulting entity's balance sheet. However mergers implemented under a leveraged buyout must have business substance in order to be tax neutral. To our knowledge, so far in practice, the Romanian tax authorities have not challenged leveraged buyouts.

Fiscal unity is not available in Romania for corporate income tax purposes. However, in case of foreign companies carrying out activities in Romania via more than one Permanent Establishment (PE) would be able to consolidate all Romanian income and expenses attributable to the PEs at the level of the PE which was assigned to handle the corporate income tax related liabilities.

As a general rule, expenses are deductible if they are incurred for business purposes. Nevertheless, expenses related to non-taxable income should be consequently treated as non-deductible. If the sole purpose of the debt is to finance the acquisition of shares in a Romanian company, the income obtained therefrom may be either dividends or income from the sale of shares (at a future potential exit). Dividends received from a Romanian legal entity are deemed non-taxable income for the recipient legal entity (SPV) CIT payer. Also, capital gains derived by a Romanian SPV CIT payer upon disposing of target`s shares is also exempt from CIT if at the date of disposal, the selling SPV has maintained a minimum holding percentage of 10% for an uninterrupted period of 1 year. Therefore, interest expenses incurred on the loan obtained to acquire the shares in the target would not be deductible for CIT purposes if the SPV earns non-taxable income.

8. Are losses of the target company(ies) available after an acquisition is made?

The target company's losses are available to be off-set against its own future taxable profits if the buyer acquires the target under a share deal scenario. If further to the share deal, the target is absorbed by the buyer, any fiscal losses recorded by the target entity can be off-set against the buyer's taxable profits.

As for an asset deal, the target's fiscal losses may be off-set only against its future profits and therefore cannot be available for the buyer.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

There is no indirect tax on transfer of shares. Sale of shares is an 'exempt without credit operation' for VAT purposes, and therefore no Romanian VAT should be charged.

10. Are there any restrictions on the deductibility of acquisition costs?

There are no specific restrictions regarding the deductibility of the acquisition costs of the assets. For instance, acquisition cost of fixed assets may be recovered via tax depreciation charges as long as the buyer uses the assets for business purposes and they generate taxable income.

Separately, other acquisition costs such as costs with services provided by finance advisory and/or legal firms are deductible for CIT purposes on the basis the taxpayer can prove that they are incurred for business purposes.

If these kinds of costs are incurred in view of a share deal, they should be entirely non-deductible if the investment generates only non-taxable income (e.g. exempt dividends received or exempt capital gains obtained in case of a potential exit based on a participation of more than 10% maintained for at least one year). Else, if the investment generates both taxable (e.g. management fees) and non-taxable income, the part of expense which should be non-deductible is to be determined based on an appropriate allocation key or based on the proportion of non-taxable income out of the total income.

11. Can VAT (if applicable) be recovered on acquisition costs?

No Romanian VAT applies, as transfers of shares are exempt without credit operations from a VAT perspective.

Any input VAT incurred by the buyer in case of an asset deal may be deducted provided that the said acquisition is made with the view of carrying out VAT taxable operations or operations exempt from VAT with credit. The intention should be properly documented.

Under a share deal, based on the ECJ jurisprudence, the recoverability of VAT incurred by the buyer on acquisitions of consulting services (e.g. services provided by finance advisory and/or legal firms) depends on the status of the buyer from a VAT perspective. For instance, if the buyer is a holding company whose sole purpose is to acquire holdings in the subsidiaries and would not directly or indirectly involve in the management of those subsidiaries, it does not have the status of a taxable person and has no right to deduct the input VAT.

Conversely, if the buyer would also be involved in the management of the subsidiaries acquired by supplying various services (subject to VAT), the buyer is deemed as undertaking an economic activity being a taxable person from a VAT perspective and being able to deduct the input VAT on acquisitions which have a direct and immediate link with the output economic transactions giving rise to a right to deduct. If the services are used by the holding company in order to perform both economic transactions giving rise to a right to deduct and economic transactions which do not, the deduction is allowed only in respect of the part of the VAT which is proportional to the amount relating to the former transactions.

12. Are there any particular issues to consider in the acquisition by foreign companies? *(for example non-resident taxation rules/substance rules and tax efficient exit routes)*

In principle the same rules apply as those applicable to the acquisition of Romanian companies (e.g. deductibility on interests of borrowings as detailed in section 6 above). In the case of the acquisition of shares of a foreign company, it is important to verify if the acquired shares can benefit from the participation exemption regime applicable to dividend income which may be subsequently earned by the Romanian corporate income tax payer, as provided by the EU Parent-Subsidiary Directive (Directive 2011/96/UE) — that is, a minimum holding percentage of 10% and minimum uninterrupted holding period of 1 year before the dividend payment (and certain formal conditions to be met).

Controlled foreign companies' legislation is not available in Romania. Starting 2014 a tax beneficial regime was introduced for the so-called holding companies, based on which dividends/ capital gains/ liquidation proceeds may be non-taxable in certain conditions (generally, the requirement is that the income beneficiary has maintained a minimum participation of 10% in the investee's share capital for at least 1 year).

Transactions between Romanian entities and their non-resident related parties must be undertaken at arm's length. The Romanian entity must prepare the transfer pricing file with specific content in line with the EU transfer pricing code of conduct, depending on the status of the Romanian entity (large tax payer or not) and thresholds of related-party transactions.

Romanian legal entities are entitled to receive fiscal credit for any tax paid on foreign-sourced income (e.g. income from dividends, interest) within the limit of the corporate income tax which would have been due in Romania in respect of the foreign taxable base (determined in accordance with the Romanian tax rules) provided that the provisions of the Double Tax Treaty (DTT) concluded between Romania and that foreign state are applicable.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

After an acquisition, the group can reorganise by way of a merger or spin-off. Mergers and spin-offs involving Romanian legal entities, as well as EU qualifying legal entities, are generally tax neutral for the difference between the market price of the assets/liabilities transferred and their tax value (i.e. no VAT and no corporate income tax

is due), provided that certain criteria are cumulatively met. In case of local partial spin-offs, the transfer should consist of one or more independent business lines towards one or more existing/new entities, while the company undergoing the spin-off operations should maintain at least one independent business line. Mergers and spin-offs must have business substance to be considered tax neutral. Domestic and EU cross-border merger and spin-off operations may not enjoy tax neutrality if they result in fraud and tax evasion detected according to the law.

The transfer of assets and liabilities is not a taxable transfer if the surviving entity maintains the tax value, tax depreciation method and useful lives of the assets transferred upon the merger or spin-off at the same level as they were prior to the reorganisation process.

The write-off of own shares is not taxable in the case of an 'upstream merger' if certain criteria are met (i.e. the absorbing entity holds at least 10% in the absorbed entity). But the write-off of own shares may be taxable in the case of a 'downstream merger'. Under Romanian legislation the write-off of own shares should be performed against equity items.

No taxation arises for provisions and reserves that were previously deemed as deductible by the absorbed entity and which are not coming from its permanent establishments from abroad, or of the reserves representing tax incentives, if such elements are transferred and maintained as such in the surviving entity's books upon merger. The reduction or usage of reserves that were previously deducted (e.g. by distribution to shareholders, usage for writing-off own shares) trigger corporate income tax liabilities.

Also the usage (i.e. for share capital increase or to off-set of losses) of legal reserves and reserves representing tax incentives trigger corporate income tax liabilities for the fiscal period when they are used.

No VAT is charged if the transaction qualifies as a transfer of a going concern (in line with the EU VAT provisions). Starting 2016, mergers and spin-offs are by default considered outside the scope of VAT if the assets are transferred to a taxable person.

Fiscal losses brought forward at the level of the surviving entity can be recovered. Fiscal losses brought forward at the level of the target (absorbed company) may also be off-set against the surviving entity's taxable profits.

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

Attention should be paid to the DTT concluded between Romania and the country of tax residence of the buyer of the Romanian target whose assets are mainly represented by Romanian real estate.

Therefore it should be checked whether, according to the above-mentioned DTT, Romania has the right to tax the capital gains received from the sale of an entity whose major assets are Romanian real estate. If this is the case, any capital gains received upon a future exit are subject to 16% Romanian corporate income tax, save for the case where the seller resident in a treaty country has maintained a participation of minimum 10% in the target`s capital for at least 1 year prior the sale.

Sell-side

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Capital gains obtained (from the sale of shares and/or of assets) by Romanian resident companies are included in their ordinary profit and taxed at the corporate income tax rate of 16%. If the seller owns for an uninterrupted period of minimum one year, minimum 10% of the share capital of the target company, the capital gains from selling the shares are not taxable. Capital losses related to a sale of shares are in general tax-deductible, save for the case where the participation meets the above holding conditions (10%, for one year).

Capital gains obtained by non-residents from the sale of shares held in Romanian companies are taxable in Romania at the corporate income tax rate of 16%. Sellers resident in treaty-countries are exempt from CIT if at the date of disposal the above holding conditions (10%, for one year) are met. If the holding conditions are not met, the capital gain may still be CIT exempt in Romania if the double tax treaty concluded between Romania and the seller's country of tax residence awards the right to tax such gains only to the other state (investor's country).

In addition the corporate seller is required to register for Romanian corporate income tax purposes either directly (in case of EU/EEA tax residents) or by appointing a Romanian tax agent to declare and pay any Romanian capital gains tax owed. Obtaining a tax number and filing nil tax returns is required even if no tax is due in Romania (e.g. by virtue of the applicable double tax treaty). The non-resident should make available a tax residence certificate issued by competent authorities in its residence jurisdiction in order to be able to invoke treaty benefits.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

The profit reinvested by Romanian corporate income tax payers in technological equipment, computers and peripheral equipment, cash registers and machineries for control or billing activities and software programs is exempt from corporate income tax, in certain conditions. This incentive is in force until 31 December 2016.

17. Are there any local substance requirements for holding/finance companies?

There is no specific substance requirement for holding/finance companies included in the Romanian tax legislation.

However, the domestic tax legislation contains certain requirements regarding economic substance related to transactions / activities ("substance over form" principle). For example, in determining the amount of a tax, a levy or mandatory social contributions, tax authorities may disregard a transaction that does not have an economic purpose, adjusting tax effects thereof, or they may reclassify the form of transactions / activities to reflect their economic substance.

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