

## WORLDWATCH

### EUROPEAN TAX UPDATE

#### Transfer pricing in Romania

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## ROMANIA

# Transfer pricing in Romania

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Within the current economic downturn, one point of concern relates to the tax authorities' reaction within the context of a tax audit vis-à-vis the type and level of expenses and revenues, and the related impact on companies. Rising unemployment will result in reduced personal income taxes while declining sales will result in reduced corporate profits and thus, corporate income tax. All these reflect in increased budget's funding needs. A substantial increase in tax audits, including those focused on transfer pricing, is expected. Tax authorities are expected to become more aggressive in collecting tax revenues which will lead to in-depth transfer pricing audits. As a foreseeable consequence, the incidence of cross-border transfer pricing disputes may rise.

The impact on transfer pricing in an economic downturn may be significant since the transfer pricing procedures commonly used during a stable economy may need to be adjusted and the previously beneficial transfer pricing planning may now produce tax inefficiencies. Any change applied however in the transfer pricing system should be properly documented: the economic substance and an appropriate business case for the change are key.

Transfer pricing is set to become an increasingly important topic as well in Romania. The

Romanian transfer pricing legislation is largely similar to the regulations applied by developed countries, making specific references to OECD doctrine and following the European Union Code of conduct on transfer pricing documentation. Although specific provisions in the field of transfer pricing have been present in Romanian tax laws for several years, the relevant legislation became more rigorous and detailed especially during last year.

In line with the regulations applied in other developed countries, Romania's Tax Code prescribes that transactions between related parties should be performed at an arm's length. In order to determine the market price for transactions between related parties, the law indicates as most appropriate methods to be used the comparable price method, the cost plus method, the resale price method, and any other method recognised in the OECD transfer pricing guidelines (i.e., net margin method and profit split method).

Romanian law stipulates that for transactions performed between related parties, the tax authorities may adjust the amount of income or expense of either party, in order to reflect the market price for the goods or services provided in the transaction. The reassessment does not affect the financials of the Romanian company (only the tax position) and is not applied if the transactions between the related parties are performed on an arm's length basis. Whether Romania has concluded a Treaty for the avoidance of double taxation (Tax Treaty) with the home country of the related party, the reassessment of income or expense shall be made considering also the article 'mutual agreement procedure' of the respective Tax Treaty.

The applicable legislation became more detailed during 2008, when clearer requirements were imposed in respect of the transfer pricing documentation content, documentation which should be made available by taxpayers upon the tax authorities' request (so far, in practice, the tax authorities did grant the taxpayers a three month window for presenting the TP file).

As such, the person carrying out transactions with related parties, upon the tax authorities' request, must present the transfer pricing study, as well as any other information required for justifying the transfer prices usually practiced. If, however, the person carrying out transac-

tions with related parties applies the provisions set by an Advanced Price Arrangement (APA) issued by the Romanian tax authorities, the transfer pricing study is no longer required for the period covered by such APA.

As currently prescribed by the Romanian tax law, the transfer pricing study file is more or less similar to that stipulated by the European Union Transfer Pricing Documentation Code of Conduct, with some local characteristics and it should contain, besides the relevant information on the group and on the taxpayer, also the functional analysis and details on the method used for the purpose of analysing the related party transactions and details on the results of the benchmarking exercise. On a case by case basis, the tax payer may be asked to provide, upon the tax authorities request, other documents aimed to supplement and complete the transfer pricing file.

With respect to the legal requirement for documenting in the study, the search criteria employed to identify local comparables, note that the benchmarking studies should be firstly carried out at local level and only if no sufficient comparables are found, benchmarking studies can be extended to the regional level (i.e., European Union).

The failure to provide the transfer pricing file will allow the tax inspectors to adjust the tax position of the Romanian entity based on their own estimation of the applicable transfer prices. Such an adjustment may lead to an increased tax burden at the taxpayer's level and also to late payment charges being imposed. Fines can be also imposed if the taxpayers refuse to provide the transfer pricing file or if such documentation is late being submitted.

In the recent months, there was a significant increase in the number of requests addressed by tax authorities for taxpayers to present their transfer pricing documentation, and we expect this trend to amplify as the authorities become more sophisticated on the topic, with dedicated teams being set up in this respect.

From a practical perspective, the transactions with related parties for which the tax authorities are likely to require a transfer pricing study are transactions with finished goods, raw materials, intangibles, those pertaining to distribution, research and development activities, finance services and other types of services such as consultancy, management, IT and hu- ►

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man resources.

As mentioned, the transfer pricing study is no longer required for the period covered by an APA issued by the Romanian tax authorities. The fee for an APA application is €20,000 in case of taxpayers whose envisaged transactions exceed €4m or €10,000, where the taxpayers transactions value less than €4m. APA amendments would cost €15,000 in case of taxpayers with transactions exceeding €4m, or €6000 where the taxpayer's transaction values less than €4m.

APA is obtained in fact based on a transfer pricing study, the taxpayer being required to

file substantial information similar to that necessary for the transfer pricing study itself. APA may be issued by the Romanian tax authorities (unilateral APA) or in common with the relevant tax authorities of the states where the related party resides (bi/multilateral APA), to the extent there is a Tax Treaty concluded. Generally, an APA is issued for a maximum period of five years, effective starting the year following that of the transaction. Theoretically, a unilateral APA should be realised by the tax authorities within 12 months and a bi/multilateral APA within 18 months.

An APA holder is required to file annually a

report regarding the observance of the terms and conditions provided by the APA issued, as well as the value of the transactions prescribed by the APA within the reference year. Failure to annually file the specific information as stipulated by the law may trigger the annulment of the APA.

We say 'theoretically' simply because up to date, no APA has been issued by the Romanian tax authorities, one of the reasons being the lack of a database needed for benchmarking researches. It is expected, however, this will soon change as all indications suggest the tax authorities recently acquired the database. ■



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