Introduction
The Romanian transfer pricing legislation follows the Organisation for Economic Co-Operation and Development (OECD) Guidelines and requires that transactions between related parties be carried out at market value. In case transfer prices are not set at arm’s length, the Romanian tax authorities have the right to adjust the taxpayers’ revenue and expenses so as to reflect the market value. Profit adjustments on transactions between related parties can be performed within the domestic statute of limitation period (i.e. six years).

The trend in transfer pricing developments in Romania reveals a growing interest of the Romanian tax authorities towards transfer pricing, which is one of the main areas of tax investigation. Under these circumstances, multinational companies are advised to pay close attention to the arm’s length of their related party transactions and their documentation so as to be prepared in case of any transfer pricing disputes with the tax authorities.

Statutory rules
The arm’s-length principle was first introduced in domestic tax law in 1994. An important milestone in the development of the transfer pricing legislative framework occurred in 2004, upon the introduction of the fiscal code, which set out in a systematic manner the definition of related parties, the statement of the arm’s-length principle and the methods for setting transfer prices at arm’s length.

The fiscal code norms detail the scope and the application of transfer pricing rules. Although Romania is not a member of the OECD, these norms expressly stipulate that in the application of transfer pricing rules, the Romanian tax authorities also will consider the OECD Guidelines.

The arm’s-length principle
The arm’s-length principle is applicable to all related party transactions, including those between a foreign legal entity and its Romanian permanent establishment. Beginning 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 scrutinised by the tax authorities.

Definition of related parties
Two legal entities are related parties provided that:
Romania

- 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.

An individual 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 (unfortunately the legislation is silent on the meaning of ‘effective control’). Two individuals are related parties provided that they are spouses or relatives up to the third degree.

**Transfer pricing methods**

Local 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). If the comparable uncontrolled price or a traditional transfer pricing method is not used, as it is the case, the taxpayer should set out in the documentation the reasons for not doing so.

Taxpayers should consider the following main criteria when selecting the most adequate transfer pricing method:

- Activities carried out by the related parties.
- Availability of data and justifying documents.
- Accuracy of adjustments to meet comparability criteria.
- Circumstances of the specific case (e.g. characteristics of the tangible goods transferred, stage within the supply chain, payment conditions, guarantees, discounts).

For specific types of transactions, guidance is provided on the application of transfer pricing methods and the comparability factors that should be considered by the taxpayer.

- Provision of services – the arm’s-length transfer price should be set using the comparable uncontrolled price method, by considering the usual fees for each type of activity or the standard rates in certain fields. In the absence of comparable transactions, the cost plus method should be used.
- Inter-company loans – the arm’s-length transfer price is represented by the interest that would have been agreed upon between third parties in comparable circumstances, including the commission for handling the loan. Comparability factors that should be considered in assessing the arm’s-length interest rate include: amount and duration of the loan, nature and purpose of the loan, currency and foreign exchange risk, existence of guarantees, costs of hedging the foreign exchange risk, etc.

**Documentation requirements**

In line with the fiscal procedure code, taxpayers engaged in related party transactions are required to prepare a transfer pricing documentation 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.

In February 2008, detailed regulations regarding the content of the local transfer pricing documentation file were published. The content of this file is in line with the Code of Conduct on Transfer Pricing Documentation for Associated Enterprises in the European Union (EU TPD).

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

**Advance pricing agreements**

In Romania, taxpayers engaged in related party transactions have the possibility to apply for advance pricing agreements (APAs). Details regarding the application procedure and the documentation that needs to be prepared by a taxpayer intending to request an APA are provided in a government decision issued in June 2007.

The APA is defined as an administrative act issued by the National Agency for Tax Administration in the view of addressing a taxpayer’s request in relation to establishing the conditions and methodology to set transfer prices in related party transactions for a fixed period of time.

The procedure is initiated by the taxpayer through submission of a request for an APA that can be preceded, if desired by the taxpayer, by a pre-filing meeting. The documentation that needs to be provided upon request for an APA is similar to the transfer pricing documentation file and needs to suggest upfront the content of the APA.

The APA can be issued for a period of up to five years and is generally valid starting from the fiscal year subsequent to the filing of the request. By 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 observed. In this view, taxpayers need to submit an annual report on these terms and conditions by the deadline for submitting the statutory financial statements.

If the 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 no longer produces legal effects.

The deadline for issuing APAs is 12 months for unilateral and 18 months for bilateral or multilateral APAs. In case of large taxpayers and for transactions with an annual value exceeding 4 million euros (EUR), the fee for issuing an APA is EUR 20,000, and the fee for amending it is EUR 15,000. For the rest of the taxpayers, the fee for issuing an APA is EUR 10,000, and the fee for amending it is EUR 6,000.

Taxpayers are classified as large taxpayers, provided that their annual turnover exceeds EUR 16.5 million; if they are banks, insurance companies or other financial institutions; or if they voluntarily make a formal commitment upon their set-up to perform investments of at least EUR 400 million.
Romania

Risk transactions or industries and legal cases
Having regard to the legislative changes and developments in the transfer pricing field, the transfer pricing audit activity has significantly increased, and requests for presenting the transfer pricing documentation file have started to become common practice.

In recent cases, the Romanian tax authorities adjusted the taxable result of taxpayers in accordance with the applicable regulations. The adjustments are carried out so that the profitability of the taxpayer reaches the median value of the arm’s-length interval derived through a local benchmarking study. Most challenges and disputes generally arise in relation to the economic analysis.

Taxpayers should address with careful consideration the documentation of their related party transactions. Having appropriate transfer pricing documentation in place is, in all circumstances, a safeguard against noncompliance penalties and adverse tax consequences, which can result from transfer pricing adjustments.

Burden of proof and tax audit procedures
In Romania, the burden of proof lies with the taxpayer who should prepare transfer pricing documentation in order to defend the arm’s-length nature of its transfer prices. In the case of litigation, however the burden of proof may shift to the tax authorities in order to demonstrate that the transfer prices set by the taxpayer are not at arm’s length.

The Romanian tax authorities should first assess the arm’s-length character of the controlled transaction by using the method applied by the taxpayer. However, in case the tax audit reveals that the arm’s-length principle is not observed, the Romanian tax authorities may apply the most appropriate method from the ones listed above.

Comparable information
The detailed regulations regarding the content of the local transfer pricing documentation file include specific provisions on the procedure to conduct benchmarking studies. These should include local comparables. European or international benchmarking studies are accepted, provided that there are no local comparables or if the set of local comparables is too limited.

Another particularity of the way to carry out the benchmarking study is that the comparability range is narrowed to the interquartile interval. If the taxpayer's transfer prices fall outside the arm’s-length range, the adjustment shall be carried out to the median.

In Romania, information on the performance of companies is available only in the form of published annual financial statements. These statements contain information that can enable computation of various profit level indicators. However, in some cases, segregation of transactions and identification of the cost base may prove to be difficult due to the particularities of the Romanian accounting system.

Additional taxes and penalties
Failure to present the transfer pricing documentation file may result in fines ranging from 12,000 Romanian leu (RON) to RON 14,000 (i.e. approx EUR 2,800 to EUR 3,300 at the current foreign exchange rate) and 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 related late payment interest and penalties. Under Romanian legislation, late payment interest and penalties are tax non-deductible.

**Inter-company loans**

Under the Romanian Fiscal Code, interest expenses incurred in relation to inter-company loans having a maturity that exceeds one year are subject to the following two limitations:

**Safe harbour rules**

Interest expenses on these inter-company loans are deductible within the limit of:

- In the case of loans denominated in hard currency (any other currency than the local currency), a ceiling established annually through government decision (i.e. 6%).
- In case of loans denominated in local currency, the reference interest rate of the National Bank of Romania.

The particularity of these ‘safe harbour’ rules is that taxpayers are not exonerated from their documentation obligations.

Interest expenses exceeding these limits are non-deductible and cannot be carried forward to subsequent years. This limitation is applied separately to each inter-company loan before considering the thin capitalisation rules detailed below.

**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.

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.

In particular, expenses with foreign exchange differences also need to be considered. Therefore, in case expenses with foreign exchange differences exceed revenue from foreign exchange differences, the difference is treated as interest expense and is subject to the limitation mentioned above. The expenses with foreign exchange differences subject to this limitation are those related to the liabilities considered for determining the debt to equity ratio.

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.
Romania

**Other considerations**
In case of related party financing, the following should also be analysed:

- Whether the loan granted serves the business interest of the beneficiary and has been used for that purpose.
- Whether there has been a profit distribution scheme.

Requalification of an inter-company loan into a profit distribution scheme occurs if, at the moment of granting the loan, a reimbursement is not expected and the agreement includes unfavourable conditions for the borrower. Under these circumstances, the loan can be reclassified as share capital; the deductibility of interest expenses and any foreign exchange differences can be challenged, and they can be assimilated to dividend payments.

**Liaison with customs authorities**
The tax and customs authorities in Romania do not usually cooperate when it comes to transfer pricing issues. The majority of customs value investigations to date have been related to the adjustment of the customs value according to Article 8 of the WTO Custom Valuation Agreement. Issues including the adjustment of customs value for royalties, licence fees, assists (e.g. packaging design, tools), and the inclusion of transport expenses were among the favourites of the customs inspectors.

However, we expect that transfer pricing adjustments, although not automatically notified to the customs authorities, will lead to further investigations and adjustments in customs as a result of the exchange of information between tax and customs authorities or as a result of their reflection in the business transactions.