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REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council = Approval

Romania's tax measures to support the maintenance/increase of own capitals (RO011)

A. Background

1. Romania notified several measures in the 2020 Standstill notification exercise:

   a. **COVID-19 measures** (measures RO009 and RO010);
   b. Other COVID-19 **related** measure (measure RO011).

2. The Group dealt already with measures RO009 and RO010.

3. This paper deals with measure RO011: reduction of income tax for maintaining/ increasing own capital.

B. RO011: Reduction of income tax for maintaining/ increasing own capital

1. General information

1. Government Emergency Ordinance (OUG) 153/2020[1] establishes tax measures to **support the maintaining/ increasing of own capital**. Emergency ordinances have the same legal status as a law and are applicable immediately; however, the Parliament must formally approve them. Such parliamentary procedure has been initiated end of 2020 and is currently still ongoing[2].

2. **The declared purpose** of the measure is to ensure additional financial resources for taxpayers who pay CIT[3] by decreasing the tax burden, as the SARS-CoV-2 pandemic caused financial difficulties for most companies. The objective of the measure is to mobilize liquidity in the real economy and to support and develop Romanian capital and the competitiveness of economic operators for the transition towards a sustainable economy.

2. Summary description

3. The measure is of a **temporary nature.** It enters into force as of 1 January 2021 and shall **apply until 2025**.

[1] Published in the Official Gazette of Romania, Part I, no. 817 of September 4, 2020.
[2] http://www.cdep.ro/pls/proiecte/upl_pck2015.proiect?cam=2&idp=18952.
[3] Or tax on the income of microenterprises or tax specific for certain activities (e.g. HORECA).

4. The measure provides for **a reduction of the annual corporate income tax due**[4] of:
   a. 2% for taxpayers which register a **positive accounting own capital (equity capital**) declared in the annual financial statements[5] at the end of the tax year when the income tax is due[6];

   b. 3% for taxpayers which register an **annual increase of adjusted own capital above a certain level** in the year in which the income tax is due compared to the reference year 2020[7]; this measure applies as of 2022;

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[4] Corporate income tax, or the tax on the income of microenterprises, or HORECA specific tax. Financial, banking institutions **are excluded.**

(5) For the purpose of this article, the **adjusted own capital** includes the following elements:

a) the paid-up subscribed capital/the endowment capital;

b) the assets of the entity/company (patrimonial regiei); (*ndlr. public entity*)

c) the public assets/patrimony; (*ndlr. public entity*)

d) the private assets/patrimony; (*ndlr. public entity*)

e) the patrimony of the national research and development institutes; (*ndlr. public entity*)

f) capital premiums;

g) the legal, statutory or contractual reserve and other reserves established from the net profit as a result of the decision of the shareholders or according to legal provisions;

h) the net result carried forward - credit balance, representing the positive difference between the credit and debit balances.

(6) The elements taken into account in accordance with para. (5) to determine the adjusted own capital are those presented in the annual financial statements/annual accounting reports.

[5] Respectively in the annual accounting reports, for the PE in Romania of legal entities residing in countries from the EEA.

[6] For the taxpayers who are required in accordance with legal provisions to establish share capital, the accounting own capital must simultaneously fulfill the requirement of being at least equal to half of the subscribed share capital.

[7] and they simultaneously meet the requirement under a) above.

The minimum percentage of increase of the adjusted own capital in the year for which tax is due compared to the adjusted own capital registered in 2020 has the following values:

Year for which the tax is owed	Minimum percentage of increase of the adjusted own capital
2022	5%
2023	10%
2024	15%
2025	20%

The increase of the adjusted own capital in the year for which the tax is owed compared to the adjusted own capital registered in 2020 shall be determined in accordance with the following formula:

$$IAOC_{year/2020} = \frac{\text{AOC of the year for which the tax is owed} - \text{AOC registered in 2020}}{\text{AOC registered in 2020}} \times 100$$

where:

IAOC - increase of the adjusted own capital;

AOC - adjusted own capital.

c. 5% - 10% for the taxpayers which register **increases of adjusted own capital** in the year in which the tax is due compared to the previous year[8], according to the percentage of increase of fiscally adjusted own capitals under the law.

The percentage of tax reduction	The intervals of annual increase of the adjusted own capital
5%	up to 5%, inclusive
6 %	over 5% and up to 10%, inclusive
7%	over 10% and up to 15%, inclusive
8%	over 15% and up to 20%, inclusive
9%	over 20% and up to 25%, inclusive
10%	over 25%

The annual increase of the adjusted own capital in the year for which the tax is due compared to the adjusted own capital registered in the previous year shall be determined in accordance with the following formula:

$$IAOC_{\text{year/prev.year}} = \frac{\text{AOC of the year for which the tax is owed} - \text{AOC of the previous year}}{\text{AOC}} \times 100$$

where:

IAOC - annual increase of the adjusted own capital;

AOC - adjusted own capital;

[8] And they simultaneously meet the requirement under a) above.

5. The reductions in a., b. and c. are **cumulative**. If two or three of the reductions provided are applicable, the percentages corresponding thereto shall be summed up to determine the value of the reduction and the resulting value shall be applied on the tax.

6. Thus, the maximum reduction as of 2022 is 15% of the income tax due (2% +3% + max 10%) if a taxpayer meets all the requirements regarding the increases in adjusted own capital. Before 2022, the maximum reduction is 5% (2% + 3%), if all other requirements are met.

7. The reduction of tax due is **only applicable** if there are taxable profits. Thus, **it cannot** create losses, nor can it be carried forward.

8. Financial and banking institutions **are excluded** from the measure**.**

9. The relevant law provides for specific provisions when reorganization operations[9] take place in the year when the tax is due and they produce effects in that year, and the way the increase in capital should be computed.

10. **No limitations in scope** or **specific anti-abuse provisions** are set in the Emergency Ordinance.

3. Preliminary remarks

a) Beneficiaries

11. All taxpayers, Romanian companies (domestic or foreign owned) and PE of foreign companies, can enjoy the tax benefit.

12. Therefore, the measure **applies generally** to all corporate taxpayers.

b) Categories of corporate taxpayers

13. Under the Romanian fiscal law, the tax liability of corporate taxpayers differs:

    a. taxpayers subject to corporate income tax are subject to a rate of 16% on the taxable profit;
    b. taxpayers subject to the tax on the income of microenterprises [annual turnover/ income not exceeding the equivalent of EUR 1.000.000] are subject to a rate of 1% [10] or 3 % [11] on the income;
    c. taxpayers performing HoReCa[12] activities pay a specific tax.

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[9] Mergers, divisions
[10] If one or more employees.
[11] If no employees.

C. NID (notional interest deductions)

14. The Group has dealt with tax regimes, which grant benefits in order to fight the debt equity bias, the so-called **NID regimes**[13]**.**

15. The RO11 measure seems to pursue a similar objective as the NID measures assessed, which is to encourage taxpayers to maintain/ increase the company's own capital and avoid financing through debt**, but the policy reasons for its introduction and its design**[14] **are different** and **applies only temporarily.**

D. Conclusion

16. To conclude, the measure applies:

    i. generally, to all taxpayers with the aim of addressing the difficult liquidity situation caused during the COVID-19 crisis;
    ii. temporary, covering 2021-2025 tax years ; and
    iii. is pending approval by the Parliament.

17. In light of the above, it is Commission services view that the measure **does not need to be assessed** at this moment. However, it is suggested that its application **is monitored** in the coming years.

E. Follow-up

The COCG agreed that RO011 measure does not need to be assessed, but future application should be monitored.

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12 Hotels, accommodation, restauration, catering…
13 Subsequently the Group approved related Guidance.
14 The previously assessed "traditional" NID regimes concerned fictitious interest deductions. Different from this, the Romanian measure at stake is a tax credit, thus a tax reduction calculated as a percentage of the CIT to be paid, the amount of which depends on the amount of increase in capital, and not a reduction of the tax base by a fictitious interest rate on the amount of increase in capital.
Differently from a notional interest deduction, a same amount of own capital increase will not lead to the same tax benefits, as this will depend on the reference own capital and on the existence of income tax to be paid (thus, taxable profits).