

STUDY

Legal framework for incorporation of a legal entity in Romania

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Summary:

- I. **Legal framework and types of commercial companies in Romania**
- II. **Payable taxes and duties by a Romanian legal person**
- III. **Comparative study Branch vs. Subsidiary (trading company) of a foreign entity in Romania**

I. **Legal framework and types of commercial companies**

The establishment, functioning, dissolution, merger, division and liquidation of commercial companies are regulated by Law 31/1990, modified and republished. In order to develop trading activities, legal and natural persons may associate and establish commercial companies. Commercial companies with the head office in Romania are legal Romanian persons. The commercial companies may be established in one of the following forms: general partnership; limited partnership; joint stock company; limited partnership with shares; limited liability company.

A. **Setting-up of commercial companies**

✓ **General partnerships and limited liability partnerships**

General partnerships and limited liability partnerships are set-up through a Contract of Company. Joint-stock companies, limited partnerships with shares or limited liability companies are set-up through a contract of company and a statute, which might be concluded as a sole document called Articles of Incorporation. The Articles of Incorporation shall be signed by all associates or in case of public subscription, by the founders and will be concluded in authentic form. The signatories of the Articles of Incorporation are considered founders. Within 15 days from the date of authentication of the Articles of Incorporation, the founders or the administrators of the company, or a representing attorney, will request the incorporation of the company in the Commercial Register in the area where the head office of the company will be located.

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✓ **Joint-Stock Companies (SA)**

Setting up of a joint-stock company can be done either by complete and simultaneous subscription of the registered share capital by the signatories of the Articles of Incorporation, or by public subscription. The registered share capital can not be lower than the prescribed legal ceiling and is represented by shares issued by the company. At the setting-up, the subscribed registered share capital, paid by each shareholder, shall not be lower than 30% of the subscribed registered share capital. The remaining of the registered share capital shall be deposited within 12 months from the incorporation. The number of shareholders cannot be lower than 5 and they are liable up to the amount of the subscribed capital. The joint-stock company is managed by one or several temporary and revocable administrators/directors. When there are several administrators/directors, they form the Council of Administration/Board of Directors.

✓ **Limited Liability Companies (SRL)**

The Limited Liability Company is set-up through the Articles of Incorporation (The Contract of the Company and The Statute). The social capital shall not be lower than the prescribed legal ceiling (Lei 2 000 000), being divided into equal shares, which shall not be lower than Lei 100 000. The number of associates shall not exceed 50. A natural or legal person may be sole partner only in one Limited Liability Company. The associates are liable up to the amount of the subscribed capital. In case the shares belong to a single person, this person being sole associate, it has the rights and obligations of the General Meeting of Associates. If the sole associate is administrator, then it undertakes also the corresponding obligations, according to the law.

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B. Setting-up of other legal entities

■ Representation offices (Reprezentanta)

The representation office is not a separate and distinct legal entity with respect to the foreign company of which it is part. Its sole purpose being to make contacts, collect and disseminate information on its parent's behalf or organize its advertising, it is not allowed to deal in commercial activities.

✓ Branches of Romanian legal entities

Branches are regulated by Law 31/1990, modified and republished .

Branches do not have legal personality. Prior to starting their activity, they are incorporated in the Register of Commerce of the county of residence. The legal regime of the branch shall be applied to any other secondary office, to which the founding company gives the statute of a branch. Branches must have the same object of activity as of the mother-company.

✓ Subsidiaries of Romanian legal entities

Subsidiaries are commercial companies with legal personality (SA, SRL). They are not secondary offices, and are set up in one of the forms of commercial companies specified by Law no. 31/1990.

The notion of subsidiary/branches refers only to company's legal form and not to capital's participation quote; nowadays presentation of consolidated accounts is not compulsory.

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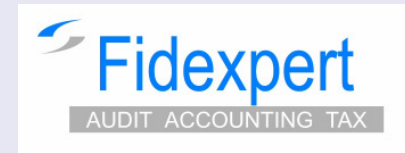
✓ **Subsidiaries (SA, SRL) of foreign legal entities**

The company is a separate and distinct legal entity with respect of the Romanian accounting and fiscal regulations

At incorporation can be chosen if the company will be considered as a profit tax payer or an income tax payer :

- a) If it is registered as profit tax payer, the company shall pay profit tax in quote of 16% applied on the taxable fiscal profit (accounting profit + fiscal not-deductible expenses - not-taxable income) ;
- b) If the result of a fiscal year is loss, this loss can be recovered from the taxable profits of the following 5 consecutive years (in case of a profit tax payable company)
- c) If it is registered as income tax payer (the annual turnover obtained should not exceed EUR 100,000): within 60 days from the date of setting up the company one employee should be hired with labor contract; the company will pay a quarterly tax in quote of 3% applied on total income obtained during that quarter (regardless of the nature and amount of expenses recorded by the company);
- d) The company could be registered from the beginning as VAT payer or as VAT non-payer. if the company does not owe VAT, the VAT related to acquisitions will be supported through costs or will be enclosed in the value of the acquisitioned goods (fixed assets or working inventories); if the turnover will exceed the amount of 2.000 RON, the company should be registered as VAT payer;
- e) If it is registered as VAT payer – in case of recoverable VAT from the State Budget (only amounts exceeding 5.000 RON), the company will submit a request for VAT recovery.

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✓ **Branches of foreign legal entities**

According to the Law 31/1990 regarding the trading companies, republished and updated, foreign companies can set up branches in Romania

Branches can not open “working places”; for each permanent office in Romania the foreign entity can open a branch

The branch represents a permanent office and as effect the taxable profit obtained in Romania is subject of the quote of 16%

Branch profit is determined by treating the branch as separate legal entity and by using the rules of transfer prices

The legal representative of the foreign legal entity should register the permanent office with the competent fiscal authority before carrying any activity in Romania

Income and expenses of the Romanian branch enclose the following :

- only the income attributable to the permanent office
- only the expenses performed in order to obtain income related to the permanent office ;

Regarding the VAT: the same aspects as in case of setting up of a Subsidiary

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II. Payable taxes and duties by a Romanian legal persons

The payable taxes and duties of a Romanian legal person are regulated by the “Fiscal Code” approved by the Law 571/2003

A. Profit tax

The quote of profit tax related to 2006 is of 16%, quote applied to the taxable fiscal profit. Taxable fiscal profit and the profit tax are calculated on quarterly basis considering the incomes and expenses from the beginning of the year (January-March, April-June, July-September and October-December).

Taxable fiscal profit = accounting profit (total income - total expenses) + fiscally not-deductible expenses – not-taxable income – fiscal loss to be recovered from the previous years .

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Examples of fiscally deductible expenses in 2006:

- Expenses incurred for labor protection, prevention of labor accidents and professional diseases;
- Advertising and publicity expenses incurred for the promotion of the business, products and/or services, if properly documented, as well as expenses for other goods and services incurred with a view to stimulate sales;
- Transport and accommodation expenses of management as well as of other authorized persons, based on contractual clauses, provided that the taxpayer realizes profit in the current and/or in the previous years;
- Subscription fees, dues and other mandatory contributions, as provided by legal norms in force;
- Marketing expenses, market research and promotion expenses in existing or new markets, participations in fairs and exhibitions, business missions, publication expenses for materials, if the taxpayer realizes profit in the current and/or in the previous years or is in a tax loss recovery period;
- Research and development expenses;
- Expenses incurred for the improvement of management, of information systems, for the implementation, maintenance and improvement of quality management systems, for the acquisition of certificates attesting the quality standards.

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Examples of fiscally not-deductible expenses:

- Protocol exceeding the limit of 2% applied to the accounting profit + protocol expenses and profit tax expenses
- Expenses related to the documents (fiscal invoices, fiscal bills, receipts, etc.) booked without being justifying documents according to the Accountancy Law,
- Expenses with the provisions exceeding the legal limits
- Any expenses performed in favor of shareholders or associates other than those generated by payments for goods and services at the market value

Examples of not-taxable income:

- Income from annulment of fiscally not-deductible provisions
- Legal reserve in quote of 5% from the gross accounting profit of the year but not exceeding 20% of the social capital .

In regard of the quarterly profit tax a statement of obligations with the State Budget it is prepared and submitted to the Fiscal Administration from the district in which the company has its registered office until the date of 25 of the month following the ended quarter.

Due term of payment for the profit tax is the date of 25 of the month following the ended quarter

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B. **Income tax**

Tax applied to small-enterprises.

Income tax quote is of 3%, applicable on total income obtained by the trading company. Quarterly calculated and paid, until the date of 25 of the month following the ended quarter.

C. **Tax on dividends**

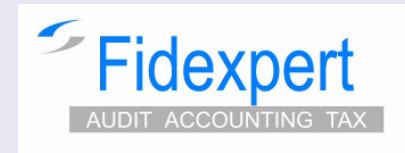
In case of participations on:

- Resident trading companies, the tax on dividends related to those shares is of 16%
- Non-resident trading companies, the tax on dividends is of 16% according to the Romanian legislation and of x% if it is subject of the Treaty for the avoidance of double taxation (treaty's provisions are applied only if the Romanian entity receives the fiscal residence certificate of the foreign entity)

Starting from the year of integration into the European Community, the tax on dividends for any sharing of a non-resident entity in Romania will be zero.

For foreign branches incorporated in Romania there is no tax on dividends; the entire net result, after taxation, can be repatriated.

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D. VAT (Value Added Tax)

In Romania, general VAT quote is of 19%

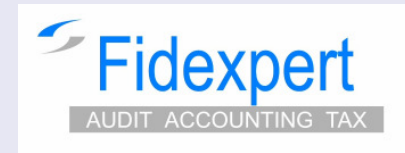
For the acquisition of fiscal invoices, the related VAT is deductible. For domestic sales with Romanian fiscal invoices, the company shall collect VAT.

Export of goods or services is not object of VAT, the exports being considered VAT exempted operations with deduction right.

Depending on the value of VAT related to acquisitions and of VAT related to domestic sales, the company could record payable VAT (output VAT > deductible VAT) or recoverable VAT (output VAT < deductible VAT). If the result is payable VAT, the due term of payment of this tax is until the date of 25 of the following period ("period" could be a month or a quarter). If the result is recoverable VAT, the company could submit a reimbursement request, but only if the amount to be reimbursed exceeds 5.000 RON.

The due date of submitting the VAT statement is the date of 25 of the following period; the same due date of payment is in case of owing payable VAT to the State Budget

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E. Salaries taxes and duties

A natural person could be hired by a legal person with labor contract on full-time (8hours/day) or part-time (2-4 or 6 hours/day).

For this employee, the legal person owes the following contributions:

- Contributions to social security (retirement contribution in a quote of 19,75% applied to the gross profit obtained in that month); the gross profit obtained in a month encloses the basic gross salary, increases, supplementary hours, bonuses, etc);
- Contribution to health insurance fund in a quote of 7% applied to the income obtained in a month;
- Contribution to unemployment fund in a quote of 2,5% applied to the gross income obtained in a month;
- Special fund for labor accidents and professional diseases in a quote of $x\%$ applied to the gross income obtained in a month (considering the CAEN code)
- Commission to the Bucharest Territorial Working Office in a quote of 0,75% (amount payable for administration of the labor contract and of the labor book) applied to the gross income obtained in a month or 0,25 if the company has personnel inspector.

From the gross income obtained by the employee in a month the following contributions are withdrawn and paid by the company on behalf of the employee:

- Tax on salary – in a quote of 16% applied on the net income obtained by the employee (net income obtained = gross income – employee’s contribution to unemployment fund – employee’s contribution to health insurance fund - a deductible amount of 250 RON – supplementary deductions such as other natural persons supported by the employee)
- Employee’s contribution to unemployment fund in a quote of 1% applied on the gross hiring salary reported per number of days worked by the employee;
- Employee’s contribution to health insurance fund in a quote of 6,5% applied on the gross income obtained per month by the employee in the period worked;
- Employee’s contribution to the social insurance fund (retirement fund contribution) in a quote of 9,5% applied on the gross income obtained by the employee in that month.

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Due date of payment for the social contributions owed by the company and also by the employee (contributions withdrawn and paid by the company on behalf of the employee) is the date of 25 of the month following the date of paying the net salary to the employee. Nevertheless, please note that the Labor Code stipulates that the taxes withdrawn from the employees should be paid within 15 days from the date of paying the net salary to the employee

For the above mentioned taxes and duties owed by the employer and by the employee, the following statements of taxes and duties must be submitted until the date of 25 of the month following the ended month:

- Statement regarding the contributions to social insurance fund– the statement is submitted to Bucharest Retirement Office
- Statement regarding the contribution to unemployment fund – the statement is submitted to Municipal Hiring Agency;
- Statement of social obligations payable by the company and by the employee – the statement is submitted to the Fiscal Administration from the district where the company has its registered office.

The payrolls, statements and taxes owed by the company and by the employee are prepared on monthly basis, monthly submitted and paid until the date of 25 of the following month for the ended month (yet, it should be considered the term of 15 days for the taxes withdrawn from the employee). On the same time, the payrolls accompanied by the copies of the payment orders for the social insurance contribution (both, company and employee) are monthly submitted to Bucharest Territorial Working Office) until the date of 25 of the following month for the month ended. Any changes of the initial information from the labor contract must be communicated to the Bucharest Territorial Working Office within 5 days from the date of signing the addendum to the labor contract; otherwise the fine amounts to 500-2.000 RON.

In case of disrespecting the payment dates above mentioned on points A, B and C, the company might pay fines in amount of 500 – 10.000 RON and penalties of 0,01% per delayed day applied on the due amount.

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III. Comparative study Branch vs. Subsidiary (trading company) of a non-resident entity in Romania

Taxes, Duties, Sundry information	Branch	Subsidiary
Legal form	Companies without legal personality.	Companies with legal personality (SRL - Limited Liability Company, SA - Joint-Stock company, etc)
Incorporation	<ul style="list-style-type: none"> -Incorporated in the Register of Commerce of the county (district) of residence. -The legal regime of the branch shall be applied to any other secondary office to which the founding company gives the statute of a branch. -Branches must have the same object of activity as of the mother-company. -The branch is not allowed to open working places as "construction sites" 	<ul style="list-style-type: none"> -Set up in one of the forms of commercial companies specified by Law no. 31/1990. -Allowed to perform any other activity -Can open working places for any construction site in the country
Personnel	-Same regime.	-Same regime.
Expenses	-As expenses has to be recorded only the expenses performed in order to obtain income related to the permanent office	-All the expenses related to entity's activity
Profit tax	-Same regime - In quote of 16%	-Same regime - In quote of 16%
Benefits repatriation	-No supplementary tax	<ul style="list-style-type: none"> -Tax on dividends 16% (x% according to the treaty) -Fara impozitare dupa integrarea in CE
Income tax	-N/A	-Only for small-enterprises

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