

Romania implements new rules for establishing tax residence

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Foreign legal entities seeking to establish tax residence in Romania based on a place of effective management must complete a questionnaire published by the Romanian tax authorities on May 17 in Order no. 577.

For legal persons who already established their place of effective management in Romania before May 17, 2021, the questionnaire must be submitted by June 30 under a requirement introduced by Law no. 296 of December 24, 2020.

Law 296/2020 established a set of precise criteria for substantiating residency in Romania based on formal registration and the place of effective management.

The clarifications introduced by the law aim at implementing transparency standards agreed by European Union member states globally and obtaining information on the foreign legal entities requesting tax residence in Romania on the basis of the place of effective management.

Criteria for establishing place of effective management

Under the new provisions instated by Law 296/2020, place of effective management is the place where, unless proven otherwise, the foreign legal entity carries out operations corresponding to economic, real and substantial purposes and where at least one of two conditions is met.

Under the first condition, the economic-strategic decisions necessary for the management of the activity of the foreign legal entity as a whole must be made in Romania by the executive directors and/or members of the board of directors. Alternatively, at least 50% of the executive directors and/or members of the board of directors of the foreign legal entity must be residents.

The Romanian tax authorities may establish ex officio or at the request of another authority, for any foreign company, whether their place of effective management is in fact in Romania.

Procedure for establishing tax residency

The questionnaire requires foreign legal persons to provide information regarding their name, state of registration, legal form in the registration state, and the object of their activity abroad. It also requires data regarding the share capital, shareholders and other holdings in the foreign legal entity, as well as identification data for the administrators, executive directors, and members of the board.

To further support establishing Romania as the place of effective management, additional documents (e.g., corporate documents of the foreign entity, trade registry certificate issued by foreign authorities, proof of operating the management place in Romania and contracts concluded with executive directors) may also be submitted along with the questionnaire.

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Law 296/2020 also updated the definition of “resident” to clarify that a Romanian resident is subject to taxation in Romania for global income obtained from any source. It is expected, therefore, that foreign companies that find Romania a friendly tax jurisdiction might wish to establish their residence hereunder.

Nonetheless, as Law 296/2020 specifies that the establishment of residence in Romania by a foreign legal person must not be based on tax avoidance through artificial arrangements.

Also, it should be borne in mind that tax residency changes determine the entrance in the reporting spectrum of the European Union Council Directive 2011/16 on cross-border tax arrangements, known as DAC6, which implies a series of additional obligations subject to significant sanctions for noncompliance.

Otherwise, it is worth mentioning that legal persons with Romanian tax residency may be subject to the 1% or 3% turnover tax (i.e., based on whether the company has employees) for companies having an annual turnover of up to EUR 1,000,000 (roughly USD 1,217,830). A 16% profit tax applies for companies whose turnover exceeds the EUR 1,000,000 (roughly USD 1,217,830) threshold.

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