TAX OPTIMISATION

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ABSTRACT: *Multinational companies operating in several states fiscally optimise their business by "choosing and implementing the optimal (economic) solution (out of various possibilities)" . In some cases, tax optimisation takes aggressive forms with the aim of avoiding tax obligations.*

Aggressive tax optimisation is mainly aimed at obtaining tax advantages through cross-border intra-group arrangements, successive transactions, the fragmentation of activities among group entities and price manipulation.

The DAC 6 Directive and the Multilateral Convention (MLI) as well as the latest rulings of the CJEU recommend limiting the avoidance of taxes in the state where the profit is made, and a major role in this regard is played by control institutions.

Keywords: *tax optimisation, cross-border arrangements, fixed establishment, permanent establishment, successive intra-group transactions*

JEL Classification: *H21, H25, F53, G31, F38, L14, D23*

1. INTRODUCTION

The guidelines of international bodies (OECD, EU, CJEU) on the taxation of the economic activities of multinational companies in the state where the profit is made have materialised in recent regulations allowing tax authorities to learn about and limit the avoidance of tax payment by transferring profit to low-tax states.

The reform of the international framework on corporation tax provides for two components:

- Pillar I – the re-allocation of part of the taxing right using a calculation formula that takes into account the number of customers/users where the multinational group operates;
- Pillar II – a rate of minimum taxation for profits made by multinational groups in order to limit the transfer of the profit to low-tax areas.

In this context, these changes can influence the Romanian tax system and can generate higher revenues for the budget from corporation tax through fair payment by companies. Thus, the use of a form of profit allocation based on a formula set out in Pillars I and II is likely to automatically lead to the elimination of complex transfer pricing rules in the EU that are difficult to implement and equally difficult to demonstrate. In Romania, the transfer pricing documentation file used for reviewing related party transactions has become an inoperative formal tool, which does not offer any consistent levers for reconsidering/reinstating transactions between affiliates, as it is usually drawn up by consultants to present the business model, not to compare transactions carried out at the market price used by uncontrolled entities. In order to prepare the shift to the new arm's length tax system, it is necessary to know and explore cross-border arrangements used by multinational companies that allow not only profit

outsourcing but also the outsourcing of turnover, i.e. of revenues made in Romania, which are not declared and, thus, not taxed.

These methods of analysis would eliminate the current taxation system based on complex and subjective transfer pricing rules, which are difficult to establish and demonstrate and which create tax disputes between tax authorities and multinational groups (that benefit from considerable expert advice).

2. AGGRESSIVE TAX OPTIMISATION

Difficult conditions faced by all states and tax competition among companies, given current difficult economic conditions, bring the aggressive tax optimisation (tax elimination/reduction) employed by multinational companies into focus.

Business fragmentation through tax records and successive intra-group transactions (intra-group transactions account for 50 to 60% of commercial transactions between companies worldwide according to some EU studies) result in a ‘duel’ between the tax bodies of each state and the representatives of these companies – specialised consultants (lawyers, experts, consultants, etc.).

In this respect, current approaches resulting from the conduct of commercial activities through undeclared permanent/fixed establishments in Romania and the taxation of profit in the country where the ‘activity’ takes place become subjects for debate between authorities, consultants and cross-border industrial organisations and can constitute ‘disputes’ with substantial direct and negative consequences on the business model.

National laws do not provide for additional constraints in the event of a reconsideration of transactions through which tax advantages have been obtained (other than their reinstatement and the imposition of an obligation to the State). Thus, there is no deterrence or legal prevention with coercive measures, and so it has allowed tax optimisations to be employed on a large scale. Intra-group transactions are all the more obvious and widespread, to a significant degree, in states where the administrative capacity (in terms of control institutions) is low or not focused on this objective.

The provision of the necessary material and human resources to the National Agency for Fiscal Administration (NAFA) is the most important link in the approach, review, investigation, process outlining and *limitation of the adverse effects of profit outsourcing*.

The exchange of information among tax authorities should identify companies using optimisation mechanisms and schemes through which tax advantages are obtained by way of successive intra-group transactions, as well as companies using formal criteria that give the appearance of compliance with standard taxation rules in the state where they operate and make a profit.

In fact, through the implemented business models, in some cases, the payment of taxes is avoided, and the profit is outsourced to states with more advantageous taxation for companies.

The tax optimisation employed by multinational companies in their activity in Romania involves using legislative gaps as a way of avoiding taxes payable and especially of outsourcing the profit.

Legal tax optimisation within fair limits is applicable when no tax advantages are pursued at all costs. Aggressive tax optimisation aims at obtaining tax advantages (tax reduction or elimination) and involves business tax planning from the registration for tax purposes with the tax body itself, using successive intra-group transactions between related parties, which are not carried out at market price (as is the case with independent entities). In order to obtain tax advantages, these entities use transfer pricing techniques and methods, the transfer pricing documentation file precisely because of the control and dependency

relationships, intra-group companies and successive transactions, which are difficult for the tax authorities to verify.

Turnover outsourcing is one of the most aggressive practices employed by multinational companies with the assistance of tax consultants and is a way for multinational companies to achieve tax optimisation for their business.

Transfer pricing refers to companies or 'structures' owned in several states that sometimes allow successive intra-group transactions which are difficult to track and tax and which are designed to obtain tax advantages as a result of exemptions, facilities and reductions in tax granted by states in certain fields.

It is possible to avoid paying taxes, as shown, thanks to the related party relationship between these companies of the multinational group performing transactions which are usually not carried out at market price (similar to independent enterprises) allowing company capitalisation, as well as distortions on the competitive market.

The tax optimisation employed uses legislative gaps and inaccuracies, a strong 'lobby' on tax regulations and laws and specialised consultancy (lawyers, experts, accountants, insolvency practitioners, tax consultants) with consultancy activity in several states allowing them to know the differences and various facilities among the various states.

The tax optimisation employed by multinational companies becomes aggressive in some cases and results in both the avoidance of corporation tax payment and the failure to collect the VAT (see Romania's VAT gap), proving the lack of administrative capacity on part of the state to collect its taxes resulting from the exploitation of material resources (mineral, energy or manufactured resources) and human resources.

The specific amount of intra-group transactions allowing the outsourcing of the profit made in Romania (the avoidance of corporation tax payment) and, last but not least, not only the non-collection of the VAT but also the reimbursement of significant VAT amounts from the state budget is unknown.

The stated goal of government objectives of achieving massive investment by attracting multinational groups is a strategic one, but the generation of budget revenues (from taxes) should equally become a top priority goal, by eliminating legislative gaps and tax inaccuracies that allow the outsourcing of profit and the avoidance of paying tax obligations for the activity carried out in Romania.

Controversy related to the declaration of the economic activity carried out in Romania by multinational companies stems in particular from the method of registration for tax purposes with the competent tax body, since the provisions of art. 49 of the Treaty on the Functioning of the European Union (TFEU) – Right of establishment entitle multinational companies to select their form of 'establishment', with the following to choose from: limited liability company (SRL) (Art. 8(37) of the Law no. 227/2015 on the Tax Code, with the subsequent amendments and additions, art. 5(2) of the Law no. 31/1990 R on trading companies, with the subsequent amendments and additions), subsidiary (Art. 42 of the Law no. 31/1990 on trading companies, with the subsequent amendments and additions) or branch (Art. 43(1) of the Law no. 31/1990 on trading companies, with the subsequent amendments and additions).

In addition to these forms of business establishment in Romania (with the assignment of a unique tax registration number by the National Trade Register Office – ONRC) under which these entities operate according to Law no. 31/1990, as republished, there are also other methods of business registration:

- A permanent establishment (Art. 8(1) of the Law no. 227/2015 on the Tax Code – the definition of a permanent establishment) – in terms of corporation tax

- A fixed establishment (Art. 11 of Regulation no. 282/2011 "in application of Article 44 of Directive 2006/112/EC" in conjunction with art. 44 of Directive 2006/112/EC on the common system of value added tax) – in terms of VAT
- A tax representative (Art. 293(1)(m) in conjunction with art. 316(61) of the Law no. 227/2015 on the Tax Code) – in terms of VAT and other obligations
- Direct registration (Art. 316(4) or (6) of the Law no. 227/2015 on the Tax Code) (for VAT only)
- A business representative office (Art. 237(3) of the Law no. 227/2015 on the Tax Code in conjunction with sub-section 88(6) of the Detailed Rules for the application of the Law no. 227/2015 on the Tax Code)
- Registration by the income payer (for income withholding tax purposes).

These forms of registration for tax purposes involve the assignment of a tax registration number (CIF) by the competent tax authority (NAFA).

Intra-group transactions carried out by multinational companies in Romania between a company (holding a unique identification code – CUI, often wholly controlled by the parent entity which is resident in another state) and the tax registration number (CIF) assigned as a non-resident entity to the parent entity in another state constitute one of the transfer pricing methods allowing the outsourcing of profit but especially of turnover (income realised) by manipulating intra-group prices (increase or decrease, according to company needs, for the avoidance of tax obligations: corporation tax and VAT).

3. THE TRANSFER PRICING DOCUMENTATION FILE

The transfer pricing documentation file (the Order of the President of NAFA no. 442/2015) (The Order of the President of ANAF no. 442/2015 on the amount of transactions, deadlines for the preparation, content and terms and conditions for requesting the transfer pricing documentation file and the procedure for the adjustment/estimate of transfer prices) and pricing methods – which determine the market value/price of related party transactions are cumbersome and formal methods because for the most part the 'appropriate' method results in disputes with tax authorities and controversy in which it is difficult to prove who is right.

Over time, the transfer pricing documentation file has become formal, subjective and inconclusive in respect of the prices charged using an average market margin which is difficult to calculate.

For example: for the contract-based activity (services) multinational companies use a margin of 3-5% applied to the cost of labour. Given the low cost of salaries in Romania compared to other states, the declared profit is also very low. Seeing as large consultancy companies advise these companies, the method has become standardised and, so, a 'formal' documentation file for the 'market' price is drawn up with an average margin of 3-5% for limited liability companies (owned and controlled by the parent entity). At the same time, the foreign entity also registers for purchases of equipment, manufacturing lines and moulds directly by the assignment of a tax identification number (CIF) only for VAT and VAT deduction (providing these free of charge – excluding VAT).

Specialists may notice that the depreciation of these goods in Romania is not an element of the cost price or an element of the establishment of the minimum rate of 3-5%.

Thus, the production activity as a whole carried out in Romania by these multinational companies has a very low mark-up rate for taxation, depriving the state budget of significant amounts, but especially generators of unfair competition in relation to local (Romanian) production companies.

It is worth noting, in particular, that by using the tax identification number (CIF), the parent entity collects finished products made through the activity carried out from the gate of its own factory, not just services.

The fragmentation of the production activity (purchases of raw materials, equipment under the held tax identification number, the performance of the contract-based labour within one's own limited liability company) and transactions – exempt intra-Community supplies (the VAT code of the Member State) are one of the most aggressive methods of 'aggressive' tax optimisation allowing profit outsourcing, as shown, through successive intra-group transactions and the manipulation of the prices of these transactions.

4. THE IMPACT OF THE CJEU CASE C 333/20 – BERLIN CHEMIE

The recent CJEU case C 333/20 Berlin Chemie (https://curia.europa.eu/juris/document/document.jsf?text=&docid=257485&pageIndex=0&doclang=RO&mode=lst&dir=&occ=first&part=1&cid=1119983) decided on 7 April 2022 (Judgment of 7 April 2022, C-333/20 Berlin Chemie, EU:C:2022:291) brings clarifications on the economic activities carried out between subsidiaries (the wholly owned limited liability company – SRL) and the parent entity, in the sense that VAT cannot be collected for the activities of the limited liability company for the parent entity for services rendered – which also falls within CJEU guidelines prior to this ruling.

But what is particularly relevant in the statement of reasons of the CJEU is that for intra-group transactions (services) the parent entity has been shown to lack the 'structure' needed to receive services on a permanent basis.

- Taking into account the fact that the statement of reasons has shown that the parent entity uses the external resources (i.e. material and staff resources) existing at the wholly owned limited liability company – a fact also substantiated by the control body in the dispute before the Romanian court, the lack of structure of the parent entity in Romania does not allow the collection of VAT (as claimed by the tax body, although it wholly owns and controls the limited liability company). The error identified which follows from the statement of reasons in the case is that the tax body has not registered the 'structure' *ex officio*, although it has demonstrated the fulfilment of the conditions for the existence of a fixed establishment in terms of VAT. *Ex officio* registration involves the assignment of a tax identification number (CIF) – according to the Order no. 2921/12.10.2016 (Order no. 2921/12.10.2016 approving the Procedure for the tax registration, either ex officio or at the request of another authority managing tax claims, of a subject of tax law that has not fulfilled its obligation of registration for tax purposes, according to the law; the issuer: the Ministry of Public Finance – the National Agency for Fiscal Administration, published in: the Official Journal no. 850 of 26 October 2016).

The preparation and submission of the official report and the issuance of the decision for the *ex officio* registration of the fixed establishment (it uses the material and human resources which it controls (on the grounds that it uses the material and human resources it controls - it owns the limited liability company - it has a permanent activity resulting from the duration of the contract/order), it has a permanent character and a fixed place of business (at the owned limited liability company). It is worth noting that the conditions for the fixed establishment are met, but it should also be pointed out that the parent entity declares domestic and intra-Community supplies through a tax representative (the tax identification number held), so the tax body can ascertain that the activity of the parent entity is carried out at the establishment of the tax representative, and the same tax identification number should also be assigned for the fixed establishment. In fact, the tax representative is a fixed establishment of the parent entity, but as shown (a permanent character, profit obtained by making supplies) it

is also a permanent establishment, since the activity and transactions prove in fact the realisation of profit.

The business fragmentation thus employed has allowed the avoidance of tax obligations in Romania. Since the transactions are related party transactions, without economic substance – in fact they are a cross-border arrangement (Art. 286(t) of the Law no. 207/2015 on the Tax Procedure Code; 01/07/2020 – the point was added by Ordinance no. 5/2020) through which tax advantages (Guide on the obligation to report cross-border arrangements (EU Directive 2018/822 – DAC 6), 2021, www.anaf.ro) are obtained by the parent entity for the activity carried out in Romania:

1. The provisions of art. 11(1) of the Law no. 227/2015 on the Tax Code are applicable:

"Tax authorities may disregard a transaction that does not serve an economic purpose, in determining the amount of a tax or a compulsory social contribution, adjusting its tax effects, or may re-classify the form of a transaction/activity to reflect the economic content of such transaction/activity."

2. The entities (the limited liability company – SRL and the group) are required to report cross-border arrangements aimed at avoiding tax obligations (corporation tax, VAT); otherwise, they are subject to a fine (art. 286 – 291 of the Law no. 207/2015 on the Tax Procedure Code and the Government Ordinance no. 5/28 January 2020 amending and supplementing the Law no. 207/2015 on the Tax Procedure Code).

In this regard, the recommendations of the European Commission of 6 December 2012 (Aggressive Tax Planning – the European Commission in Recommendations on aggressive tax planning (2012) defines this phrase as an advantage obtained as a result of legislative details of a tax system or discrepancies between two or more tax systems, in order to reduce the tax obligations of the DAC 6 Guide) on aggressive tax planning stated that: "An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance."

These artificial arrangements are not subject to double taxation conventions, either.

5. THE APPLICATION OF THE MULTILATERAL CONVENTION (MLI) IN ROMANIA

In January of 2022 Romania ratified the Multilateral Convention and notified the implementation of review measures concerning:

- The permanent establishment – *it would no longer be possible to fragment the activity* by interposing another group entity;
- *The economic substance of transactions* – treaties do not apply to artificial transactions;
- *The exclusive use of the tax credit method* (the exemption method is waived in order to eliminate double taxation).

Thus, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – MLI, the latest rulings of the CJEU (see Cases: C 333/20 Berlin Chemie, C 98/21 Finanzamt R), EU Directive 1164/2016 (Art. 6 of Directive 1164/2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market – General anti-abuse rule), the DAC 6 Directive (Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements) are sufficient tools and offer applicable/relevant legislative 'remedies', depending on the case, to allow the reconsideration in intra-group transactions of the economic activity carried out in Romania and the reinstatement of tax obligations similar to 'independent' persons, i.e. at market price.

The influence of a reconsideration of the activity/transactions between group members can be substantial/significant, and, so, it is necessary to change the business model in order to comply with applicable legal provisions. Following a tax inspection, the consequences can be significant for both the activity and the image of the entire group of multinational enterprises.

6. CONCLUSIONS – FUTURE DEVELOPMENTS IN THE TAX POLICY

In view of the fact that the European Commission is preparing amendments to Directive 2011/16/EU (ATAD III) in order to identify entities without economic substance (shell companies) and to reinstate artificial transactions for taxation purposes in the near future, it is the tax inspectors' responsibility to review, ascertain and substantiate the entire (rather than fragmented) state of affairs in terms of tax for the taxpayer, and it is the taxpayers' responsibility to justify the economic substance of the transactions.

This requires the establishment of inspection procedures and procedures for reconsidering/reinstating transactions in a transparent way, as approved by the business environment, as well as adequate remuneration for the staff involved in such complex activities, accompanied by legal protection for the civil servants exercising powers of authority of the Romanian state.

Romania's notifications and proposals regarding the application of the provisions of the Multilateral Convention (MLI) will have a major impact on implemented business models and require their re-examination in the case of aggressive tax optimisation (which uses cross-border arrangements in order to obtain tax advantages). Otherwise, companies will expose themselves to tax inspections based on transfer pricing risk analyses – as a result of successive related party transactions.

The reconsideration of transactions or of the reclassification/reinstatement of the economic activity carried out in Romania by multinational companies due to the failure to declare the permanent establishment (in terms of corporation tax) or the fixed establishment (in terms of VAT) to the competent tax body can have significant effects in terms of both the amount of the tax obligations established as a result of tax inspections, and the reputation and image on the multinational company.

Disputes between tax authorities and foreign entities that aggressively optimise and plan their business with the aim of avoiding tax obligations can be eliminated by creating a stable business environment that fairly pays its tax obligations in a competitive, transparent context.

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