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Recipe for Successful Tax, Law & Real-Estate of Regional Operations Centers in Romania

Foreword

Romania's remarkable success as an investment destination for multinationals looking for a jurisdiction to set up various service centers is the result of many attributes, including: strategic geographic location, highly educated yet not so costly labor force, as well as appropriate office space.

Tax and legal regimes also play a favorable role in the investors' decisions. Recent amendments to the Romanian tax legislation, have been mostly for the benefit of taxpayers in the form of rate reductions (such as in VAT) and exemption of tax on certain benefits for individuals. Special incentives for IT programmers are particularly interesting, as well as corporate tax deductions for R&D activities or reinvested profits.

With both corporate tax and individual income tax rates at 16% and dividend taxation mostly eliminated in accordance with EU directives or bilateral tax treaties, Romania is a competitive jurisdiction for foreign investors.

In addition, the legal system is very similar to what one would expect in a continental law, EU member state, with strong protection of investment. With relatively little bureaucracy and virtually no restrictions in terms of shareholding and directorship, corporate law is also investor-friendly.

I hope our material will help you in your decision of setting up your regional center in Romania!

ALEXANDRU REFF

Country Managing Partner
Deloitte Romania

I have been in the real-estate industry for all my professional life and I have to admit that nowadays we are living one of our best times, with transactions that exceed many of the previous levels and that are close to those in Central Europe.

We strive to match people and property perfectly. As such, we are constantly investing in market reports that best answer market needs, because I believe research is fundamental to guiding our clients and our business. The idea of this specific one was to provide both new-comer and experienced tenants and developers, operating in Romania, with a short booklet offering quick answers to tax, law and real estate questions.

Romania, with an ever increasing attractive reputation as a destination for operational centers, had an economic growth of 4,8% in 2016 and is estimated to register the highest growth rate in 2017 in Europe. Operations Centers have all the stars aligned: very good tax & legal grounds, high quality office spaces and an affluence of highly skilled and well prepared professionals.

We hope our report will be of great aid for you and your organization!

If you would like to discuss any property matter, do please contact myself or one of my colleagues listed on page 11. We will be delighted to help you.

HORATIU FLORESCU

Chairman & CEO
Knight Frank Romania

Tax Implications

For almost two decades, Deloitte has been conducting biennial surveys to understand how regional operation centers are capitalizing on leading practices and trends to address their business challenges and better meet their customers' needs.

In Romania, special attention has been granted to the creation of regional operation centers and business process outsourcing units, due to favorable trends and facilities on the Romanian market.

Several legal and fiscal aspects are of particular interest for the establishment and operation of a regional operation center or a business process outsourcing unit.

Accounting compliance obligations

General rules

Companies have to prepare their financial statements in accordance with Romanian Statutory Accounting Law. The preparation of two sets of the statutory financial statements is required ~ One half-year accounting report, if the entities meet certain financial criteria established by law, and year-end full set of financial statements including the Administrator's report.

Companies are obliged by law to prepare the manual of accounting procedures and flow of financial and accounting statutory documents.

Compliance requirements

Companies have the possibility to choose a different financial reporting date than the calendar year. If this is the option, the entities have to prepare three sets of financial statements, one for the calendar year that ended, the accounting reporting for the middle-year and one full set of the financial statements for the new selected financial reporting date.

Corporate income tax

General rules

According to the Romanian tax provisions, the tax base for computing the corporate income tax due is the difference between income and expenses from any source, reduced by non-taxable income and increased by non-deductible expenses. Items similar to income and expenses are also taken into consideration when computing the CIT due. The corporate income tax rate is 16%.

In addition, the Romanian tax legislation grants certain tax facilities, such as a tax exemption on reinvested profits or research and development facility.

Tax facilities

Reinvested profit

Companies may apply a tax exemption in relation to the profit that is reinvested in certain new technological equipment, computers and peripheral equipment, software programs, as well as the license to use such software.

The value of the technological equipment's investment should be deducted only from the gross accounting profit of the fiscal year.

The technological equipment should be put into operation during the fiscal year the investment was performed and should be used for business purposes.

Research & Development (R&D)

Companies exclusively engaged in innovation activities and R&D (defined under the relevant legislation) are exempt from corporate income tax obligations for the first 10 years of activity.

Romania offers a 50% extra deduction for eligible R&D expenditure. Additionally, accelerated tax depreciation for equipment and devices used in R&D activity of up to 50% of the fiscal value of the asset may be deducted during the first year of use. The remaining fiscal value of the asset is depreciated over the remaining useful life.

Other aspects – fit-out contribution

When it comes to rental agreements, cases exist when the lessor may offer certain incentives to the lessee, such as: paying in advance or reimbursing to the lessee certain costs (e.g. improvements to the leased spaced, certain relocation costs, costs related to previous rent agreements etc.), free rent months throughout the agreement etc.

Compliance obligations

Companies should fulfill their CIT reporting obligations on a quarterly basis, on the 25th of the following month. The deadline for fulfilling the annual compliance obligations is on the 25th of March of the following year.

The Romanian tax legislation offers to companies the possibility to apply the quarterly prepayment system or to choose a different fiscal year than the calendar one.

Personal income tax

General aspects

According to the Romanian legislation, the personal income tax is of 16%, to which mandatory social contributions are added (i.e. approx. 23% due by the employer and 16.5% due by the employee).

In addition, the Tax Code grants certain tax incentives for employees, such as:

— Deduction for contributions to private pensions or to private health insurances;
— Moving expenses – non-taxable for salary tax purposes;
— Training expenses – non-taxable for salary tax purposes;
— Stock option plans – preferential taxation may apply depending on the plan;
— Salary tax exemption for employees performing software development or research and development activities (under certain specific conditions that should be analyzed on a case by case basis).

Compliance obligations

Companies must fulfill their reporting obligations from a personal income tax perspective on a monthly basis, on the 25th of the following month.

VAT

The Romanian VAT law is in-line with the European VAT rules provided by the Directive 2006/112/EC. In this respect, based on the general rule the place of supply of services is the place where the beneficiary is established. Attention should be paid to the cases when the beneficiary has fixed establishemnts which are located in other jurisdictions than those in which the services are rendered.

In most of the cases, regional operation centers are in a VAT refundable position. Based on the Romanian law, the VAT refund should be approved in 45 days upon submitting the VAT return opting for the refund. Depending on the tax risk of the entity, tax audits could be performed before approving the refund. Delay penalties can be claimed if the refund is not solved in due time.

Tax Rate

The Romanian tax legislation provides for a general VAT rate of 19% and two reduced rates, 9% and 5%, applicable only in specific cases.

Compliance obligations

The reporting period is the calendar month. However, if the turnover is below €100,000 and no intra-community acquisition of goods are performed, the reporting period is the quarter.

The VAT return should be submitted by the 25th of the month following the reporting period.

Transfer pricing

From a transfer pricing perspective, the Romanian legislation is generally in line with the OECD rules. Transactions between related parties should observe the arm's length principle.

From a compliance perspective, transfer pricing documentation (a local transfer pricing file) should be prepared by companies to sustain that the prices used for inter-company transactions observe the arm's length principle.

Others

Advance pricing agreements may be requested upfront by the tax authorities in order to secure the correct intercompany prices for a period of five years. This term may be further prolonged.

The tax treatment for a future transaction may also be secured through a binding tax ruling.

Both the advance pricing agreements and the binding rulings issued by the tax authorities are valid as long as the transactions remain the same and the tax legislation on which they are based is not amended.

Legal Implications

Incorporation/ Structure

Even if a global corporate structure is firmly established before a regional operation center initiative is launched, its structuring is an important task to be taken care of. The biggest challenge comes when choosing which type of structure better suits the parent company's needs. Corporate structuring options are:
– a separate legal entity;
– a subsidiary of the operating parent or of the holding company parent;
– a branch or a department; in such case, the entity would have a separate accounting from the main company, but there would be no separate legal entity.

When deciding the corporate structure, there are many legal implications to consider and matters like shareholdings, governance, powers, voting rights and exit arrangements must be taken into account.

Location

The location of the regional operation center should be carefully analyzed. If opting for a lease, which may offer more flexibility and reduced costs, the following aspects are of particular interest:
– who will bear the fit-out costs and whether or not compensation of payment mechanism will apply (e.g. in case of granting rent-free periods), as exemption may be considered landlord's contribution to the fit-out works;
– whether the tenant shall have the possibility to sublease the space, with or without the landlord's permission;
– the liabilities and indemnities aspects, namely which are the risks that shall be assumed by the tenant and what type of indemnities should it expect to be liable for;
– what type of insurance policies are necessary so as the tenant is covered on a large basis while having to incur as little costs as possible;
– which party assumes the regulatory responsibilities and, if shared, which compliance obligations should be assumed by the tenant;
– potential competition implications require careful drafting of any restrictive clauses in the lease agreement.

If the better option is buying the space, from a legal point of view the following steps should be followed:
– performance of a due diligence analysis of the ownership title, so as to discover the risks involved and check the validity of the title;
– negotiation of the sale and purchase agreement;
– and, overall, the implementation of a good negotiation strategy, both from a legal and a commercial perspective, such as to insure that the position of the buyer is heard and appreciated.

Service level agreements

The Service Level Agreement (SLA) forms the basis of the relationship between the beneficiary, which is generally the legal entity requiring the services of the regional operation center, and the service provider entity, by contemplating what services the provider will furnish and which are the standards the regional operation center is obliged to meet.

The SLA process also provides valuable performance information to help the regional operation center to understand and deliver suitable levels of resources, skills and service.

The SLA process is in fact a quality process, using customer input to set target delivery levels, and then measuring against these targets to identify if new resources or systems are needed.

The drafting of this agreement is of high importance as it defines the scope of the services, the frequency of such services, technical data required for providing the services, costs and, mainly, the legal responsibility of the parties. While the regional operation center could be a department or a subsidiary of the parent corporation, the free-market principles still apply, meaning that the effectiveness (balance of the costs and income) and competitiveness of the center have to be insured in order to reach the scope of such a center.

Notwithstanding the fact that there might be the case of a close relationship between the parties to the SLA, provisions related to the breach of the agreement should be carefully drafted, specifically regarding the manner of compensating the customer, warranties granted by the provider, as well as liability and penalties. Usually a master agreement is created, which establishes the general terms and conditions applicable to all the customers.

Employment implications

Upon designing the structure of a regional operation center, several employment law aspects should be considered, such as the potential applicability of provisions regulating the safeguarding of employees' rights in case of transfer of undertakings, businesses or parts thereof – TUPE Regulations. Therefore, it should be verified whether the object of the transfer to the regional operation center constitutes an identifiable economic entity that, following the transfer, will continue performing essentially the same activities as before the transfer. For example, the following factors should be contemplated: whether or not the majority of the workforce is taken over by the regional operation center, the degree of similarity between the activities performed before and after the transaction, the structure of the activity etc.

Provided TUPE Regulations apply, the regional operation center will take over all rights and liabilities in connection with the workers employed in the departments envisaged to be outsourced.

Additional challenges may arise in cases where employees are relocated from other countries, in relation to aspects such as (i) the law applicable to the employment contracts; (ii) harmonization of working conditions applicable to employees; (iii) mobility issues (e.g.: relocation of employees and their families).

Moreover, setting up a new company also triggers the obligation to comply with specific Romanian employment law requirements, on issues relating to the organization of the working time, health and safety regulations, drafting of an internal regulation, nondiscrimination etc.

Others

Establishing a regional operation center involves taking repetitive common processes out of individual business units and moving them into a stand-alone organization, freeing up the business to spend more time performing higher value-added tasks.

Hence, it is a complex process that raises various legal and commercial questions, on top of the ones already presented, such as:
– regulatory aspects impacting sourcing operations;
– due diligence reviews;
– analysis and development of process policies;
– provision of a project assurance framework for development and implementation;
– data protection aspects;
– employment compliance;
– undertaking of risks/liability.

State Aid

Romania offers highest State aid and EU funds intensity in CEE (up to 50% for large companies or 70% for small companies) in various domains: manufacturing, IT&C, R&D, energy efficiency, agriculture, tourism etc.
A regional operation center may apply in order to get:
– Subsidies for jobs creation (up to 50% from the salary costs for 2 years) and
–EU funds for staff training (up to 95% of the training costs).

EU funds for staff training

Human Capital Operational Programme 2014–2020	
Beneficiaries	37,900 employees from 245 companies (74 large and 171 SMEs)
Financed activities	Training employees in private companies
Total allocation at national level	€108 mil
Average grant per one employee	€2,849
Maximum grant per company	€200,000
Funding limit as % of eligible expenses	Up to 95% (subject to further decision of the Managing Authority applicants guidelines not yet public)
Other information	– all the costs related to the training have to be incurred after the company receives the project approval from the Managing Authority – costs advanced before getting the approval are not eligible and will not be reimbursed

State aid for jobs creation

Government Decision 332/2014 | Open call 12–23 June 2017	
Minimum number of new jobs to be created	10 minimum new full-time jobs, including 3 for disadvantaged workers
Minimum value of investment	No requirement
Activity sectors	All sectors; exceptions are driven by registration codes (aka NACE codes) that are explicitly listed in the Government Decision 332/2014
Relocation of other EU factories/activities to Romania	Forbidden for applicants that: – closed identical or similar activity in the European Economic Area in the past 2 years – have plans to close such an activity 2 years after completion of the initial investment in Romania
Eligible costs	– Salary costs (gross salary plus employer's social contributions) – Maximum eligible value for salary costs/employee/month is the country's **average gross salary** (**approx. €680**) – The eligible period for salary costs is the **first 24 months** from the date of creation of each new workplace – E.g.: Incentive value for a company that opens or extends its business in a region where the aid intensity is 50% and hires 100 employees is **€1 mil**.
Changes during implementation of investment plan and business plan	– Changing the location of implementation is allowed in a region where the maximum intensity of state aid stays the same – Only one change allowed related to the initial forecast timing of job creation and maintenance – Only one change allowed relating to a maximum 20% reduction in the number of newly created jobs
Profitability requirements	For existing companies: – net profit margin > 1% for the last closed financial year – positive equity for the last closed financial year

Bucharest Office Market Overview

Key findings

Romania's economy grew by 4.8% in 2016, the fastest rate since 2008 and is estimated to register the highest economic growth rate in 2017 in Europe.

Bucharest's office market registered one of the strongest years of take-up in 2016 reaching nearly 350,000 sq m.

Leasing activity was led by IT and Communication and Business Process Outsourcing (BPO) companies.

An increase in construction activity has compensated for low office volumes in recent years.

Romania's commercial real estate investment volumes totalled €706 million in 2016.

Prime office yields remained stable at 7.5% and only moderate yield compression is anticipated during 2017.

Bucharest market overview

The office supply in Q1 of the past five years went downward from 72,000 sq m in 2013 to 9,550 sq m in 2017. This decrease in Q1 2017 was expected, because of one of the largest volumes of new, class A & B offices delivered last year – over 293,000 sq m. There were two new schemes delivered in Q1 2017, Aviatorilor 8A of NEPI (7,250 sq m) and Dorobantilor 33 of Downtown Center (2,300 sq m), both in CBD (Central Business District). This brings the total stock of modern office spaces to 2.5 million sq m.

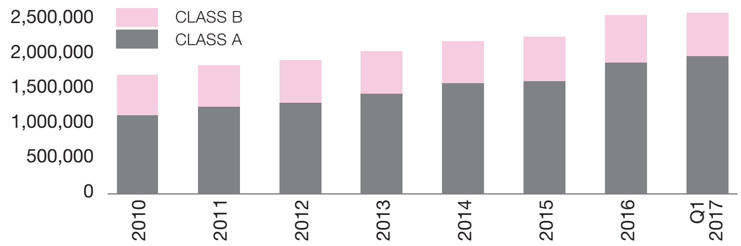
Q1 2017 saw class A & B take-up reach approximately 98,300 sq m, a 17% increase compared to the same period in 2016. Over 55% of these were renewals/renegotiations mainly in the IT&C and automotive industries, followed, just like in 2016, by relocation and new demand (approximately 26%), whereas the pre-lease activity was very low, only 6%.

Of particular note is the growth of the average transaction size, which increased from approximately 1,800 sq m in Q1 2016 to approximately 2,350 sq m in Q1 2017. This comes as no surprise, as we expect average transactions size to grow even further in the upcoming two years. Transactions below 1,000 sq m were most numerous in Q1 2017, similar to the same quarter of last year, but still accounting for less than 15% of the total take-up.

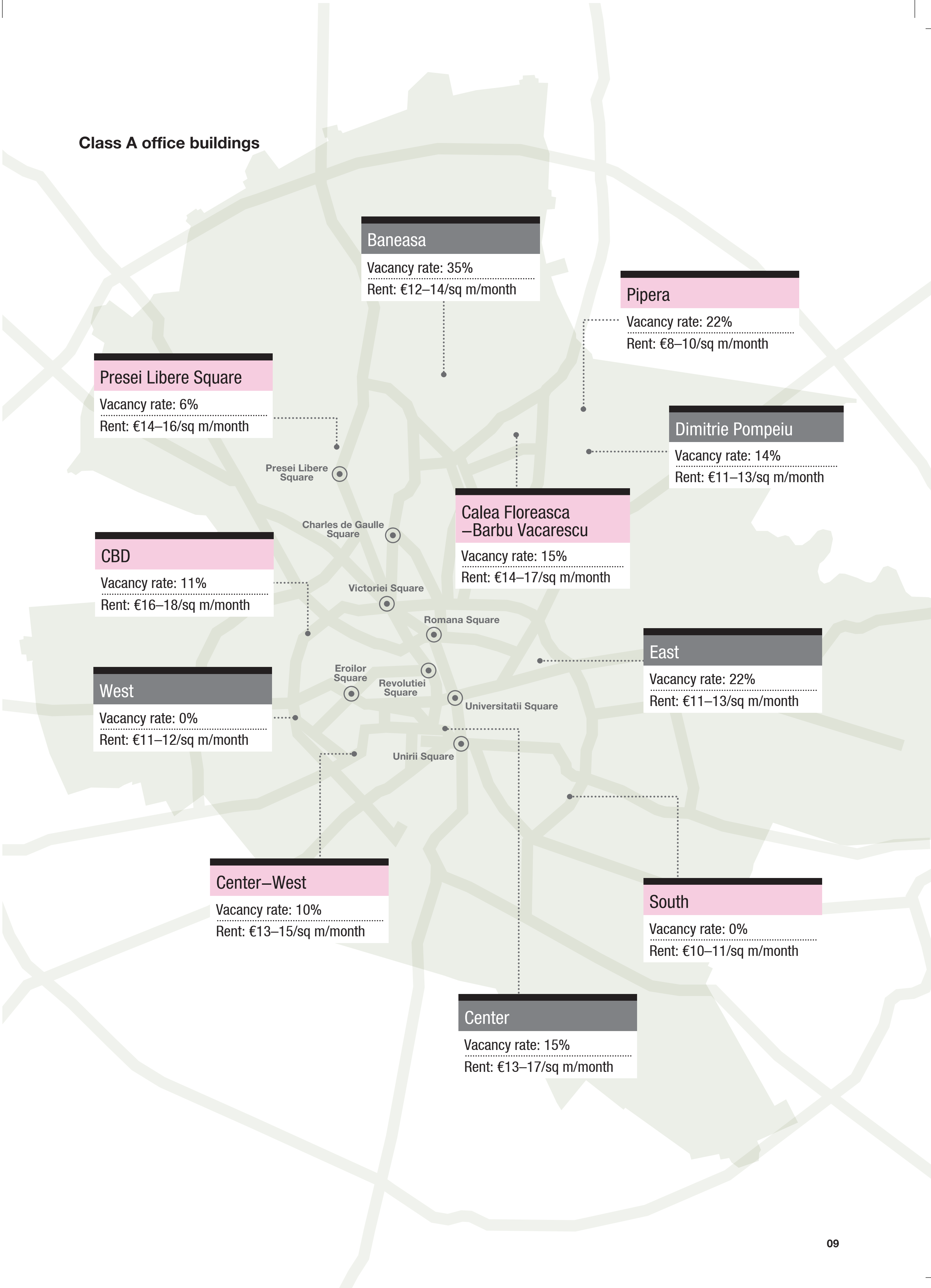
Rents were comparable to previous years. Prime headline rents remained unchanged and were reported at around €18–18.50/sq m/month. Service charges have also remained stable, ranging between €3.50–4.50/sq m/month.

Outsourcing companies will continue to enter and expand into the market. Developers have demonstrated their ability to offer multi-national companies customised office solutions at lower rents than in some other CEE markets, and the growth in this industry will continue to lead to change in Bucharest's occupational market dynamics.

Modern office stock
Annual evolution (sq m)



Class A office buildings



Some of the Regional Operations Centers in Romania

Office market in primary cities in Romania

	Stock (sq m)	Headline Rents (€/month/sq m)	Vacancy Rate (%)
Cluj-Napoca	150,000	10–14	30
Timisoara	55,000	12–14	<5
Iasi	120,000	12–14	15

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