

Tax treaty Policy of Romania

I. Tax Treaty Network of Romania

In Romania, the political-historical context has favored the development of a system of agreements and conventions for avoiding double taxation (tax treaties), which had before 1989 both a fiscal component and an extremely interesting political aim. These treaties marked or overlapped with tensed periods in the relation with the USSR and aimed at conveying the image of state having an independent international and economic conduct.¹ The first convention for the avoidance of double taxation was signed in India and covered the taxation of income resulting from operating aircrafts and ships in international traffic. The tax treaty was signed at New Delhi, on September 25th 1968.² In the aftermath, a series of international tax treaties were signed with “capitalist” states, their role being that of marking the new president Nicolae Ceaușescu’s independence policy in external politics. Thus, between 1973 and 1974, tax treaties were concluded with Germany³, the USA⁴, France⁵ and Great Britain⁶. The same type of treaty was concluded with Austria in 1976⁷.

In 1977, at Miskolc, Hungary, Romania was a contracting party of the Multilateral agreement regarding the avoidance of double taxation on income and property of natural persons and later part of the Multilateral agreement regarding the avoidance of double

¹ Saguna, *Drept fiscal*, Ed. C.H. Beck, București, 2006, pag.21.

² See Council of Ministers Decision no. 2560 of November 19th 1968, regarding the ratification of the Convention for the Avoidance of Double taxation of Income from the Operation of Aircrafts and Ships in International Traffic, New Delhi, September 25th 1968.

³ See State Council Decree no. 625 of November 21st 1973 regarding the ratification of the Convention between Romania and the Federal Republic of Germany for the avoidance of double taxation of property and income, Bonn, June 29th 1973.

⁴ See State Council decree no. 238 of December 23rd 1974 regarding the ratification of the Convention between the Socialist Republic of Romania and the United States of America for the avoidance of double taxation of property and income, signed on December 4th 1973.

⁵ State Council Decree no. 240 of December 23rd 1974 for the ratification of the convention between Romania and France for the avoidance of double taxation on property and income.

⁶ State Council Decree no. 260 of November 3rd 1976 for the ratification of the Convention between Romania and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation on property and income.

⁷ See State Council Decree no. 254 of July 10th 1978 for the ratification of the Convention between Romania and the Federal Republic of Austria for the avoidance of double taxation on property and income, signed at Vienna, on September 30th 1976.

taxation on income and property of legal persons, signed at Ulan Bator, Mongolia, on May 19th 1978 and ratified by Romania by Decree no. 432 of 1978. The general principles of the two tax treaties are identical. They set up the general rule that the income drawn by a resident of a state who conducts business activities in a different contracting state, shall be subject to taxation only in the contracting state in which the respective person has his/her domicile or business location, which is equivalent with the implementation of the principle of taxation in the country of residence of the beneficiary of income. The multilateral tax treaties came after a series of agreements and conventions inaugurated through the foundation of the Council for Mutual Economic Assistance in 1949, as initiated by the USSR. On December 29th 1985, Moscow, Romania and the USSR signed the Agreement on the Exchange of Goods and Payments between 1986 and 1990.

After 1990, a series of tax treaties were reassessed and amended according to the historical epoch and the political regime.⁸ At present, Romania has a network of 77 bilateral treaties, of which the most often used are those signed with the Netherlands, Austria, Germany, Italy, France, the USA, Luxemburg, Cyprus and Great Britain. The tax treaties concluded by Romania follow the OECD Model Convention, exhibiting however certain peculiarities we intend to analyze in the present paper.⁹

II. The Bilateral Tax Treaty Provisions for Romania

1. Personal Scope

The definitions of the main terms are included in articles 3, 4, 5 of the conventions for the avoidance of double taxation concluded by Romania.¹⁰ Usually, article 3 par. 1 of the conventions concluded by Romania defines several of the most frequently used terms in tax treaties, whereas art. 3 par.2 establishes the general

⁸ Minea/Costaș, *Dreptul finanțelor publice. Drept fiscal vol II*, Ed. Sfera Juridică, Cluj-Napoca, 2006, pag. 35

⁹ Russo, *The 2005 OECD Model Convention and Commentary: An Overview*, in *European Taxation, December 2005*, p.560-565.

¹⁰ Condor, *Drept fiscal. Evitarea dublei impuneri pe venit și pe avere*, Ed. Tribuna Economică, Ed. Tribuna Economică, 1999, p.23-40.

interpretation rule for defining the notions that are not explicitly defined in the treaties. In general, regarding this issue, the treaties signed by Romania, follow the OECD Model Convention. As an exception to the rule, to the convention concluded with Malaysia, the solutions of the UNO Model Convention were applied. Furthermore, the solutions of the UNO Model Convention were also applied to the convention signed with India, however with one amendment. Thus, article 5 paragraph 4 of the Convention provides that "regardless of the provisions in paragraphs 1 and 2, when a person other than an independent agent for which paragraph 5 is applicable, acts in a contracting state on behalf of a company pertaining to the other contracting state, the permanent establishment of that company shall be considered to be in the first state, provided that

- a) it has and regularly makes use of the authority to conclude agreements in that state, on behalf of the company, unless his activity is limited to the purchase of products or commodities for the company.
- b) the person does not have such authority, but usually keeps a stock of products or commodities in the first state, using it to make regular product or commodity deliveries on behalf of the company or
- c) usually receives orders in the first mentioned state, entirely or almost entirely for the company itself or for the company and other companies that manage or are managed by or are subject to the same mutual management as the respective company.

We may notice that these conventions also accomplish the aim the experts who had drawn up the UNO Model Convention had in view, namely to expand the taxation right in the country of source of income, in our case the state accommodating the permanent establishment.

The Tax Treaties specify that corporate entities are liable to pay tax in their country of residence (the Treaties contain 'tie-breaker- clauses to resolve cases in which both countries assert residence). If an entity which is resident in one country has a permanent establishment in another country, then the income from the permanent establishment is taxed in the second country. Individual taxation is also calculated on the basis of residence, but in cases where income could be taxed twice there is either a 'tie-

breaker' clause or a provision offsetting tax paid in one country against tax due in the other for the same income (or an exemption).

Partnerships without legal personality fall under the scope of the convention for the avoidance of double taxation and are defined in general in art. 3 paragraph 1 as "other types of partnerships between persons". NPOs, to which the provisions of the conventions apply, are also included in the same scope of definition.

Law 411/2004 regarding administered pension funds and Law 204/2006 regarding optional pensions regulate the organization and functioning of pension funds as trade companies with a minimum equity capital of 4 million Euros.

Concerning the circulation of the beneficiaries of this system within the community boundaries, the Romanian legislative adopted Law 23/2007¹¹ that implements the provisions of the Council Directive 98/49/EC of June 29th 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community. The law indirectly refers to the Conventions on the avoidance of double taxation for regulating correct and equitable taxation of pension funds. Limitation on benefits clauses (LOB) are familiar concepts in the context of U.S. treaties. Such a clause exists only in the Romanian-US tax treaty.

The concept of 'treaty-shopping' has not been treated from a serious analytical perspective in Romania. It was rather regarded as an opportunity for Romania, since Romania was considered a target for the companies looking for friendlier tax regimes. In this respect, the national laws do not comprise any prohibitive regulations in this field.

2. Taxes Covered

The tax system defined in article 2 of the conventions for the prevention of double taxation of Romania follow the OECD model,¹² including the income tax, the profit tax and the propriety tax. Considering that there is no inheritance tax in Romania, the

¹¹ Published in the Official Journal, Part I No. 61 as per January 25th 2007

¹² See Lang, "Taxes Covered" - What is a "Tax" according to Art. 2 OECD Model Convention?, Bulletin for International Fiscal Documentation 2005, 216 ff.

international tax treaties do not cover this kind of tax. Romania has not concluded any special tax treaties in this respect.¹³

3. Allocation Rules

a) Income from Immovable Property (art. 6)

Income drawn by a resident of a contracting state from the exploitation and lease of real estate located in the other contracting state is taxed in the second contracting state. The applicable law is that of the country in which the real estate is located, namely the source of income legislation.¹⁴ Regarding tax treaties, Romania follows the OECD model. In order to give a detailed account of the regulations provided in article 6, we have to mention the provision included in the tax treaty concluded with Finland in 1978, which states that “in case the property right over the shares or equity shares of a company entitles the holder of the shares or equity shares to use certain real estate properties, that are the ownership of the company, income obtained from the direct exploitation, lease or any other kind of use of such usage right is taxable in the state where the real estate is located”.¹⁵

b) Business profits (art.7)

The term ‘company profits’ or ‘business profits’ has a large meaning, including all profits resulting from economic activities of a legal entity. Some tax treaties concluded by Romania with regard to the avoidance of double taxation clearly outline the scope of this concept. Thus the convention with the USA provides that “the expression industrial or commercial profits includes, without limitation, the income obtained from manufacturing, commercial, banking, insurance, agricultural, fishing and mining activities, activities regarding the operation of ships or aircrafts, services, lease of

¹³ Ștefănescu, *The avoidance of the international double taxation in the conventions* concluded by Romania, presented at The VII-th Symposium of Tax Law organized by the Ministry of Finance of Romania in Cluj-Napoca, 1995, p. 476-478.

¹⁴ Condor, *Drept fiscal. Evitarea dublei impuneri pe venit și pe avere*, p.53

¹⁵ See art. 6 paragraph 4 of the Convention between Romania and Finland, published in the Official Journal No. 16 as per March 6th 1978.

tangible goods. This notion does not include personal services rendered by a natural person, neither as an employed nor as a self-employed person. This notion also includes any other income explicitly related to a permanent establishment a resident of a contracting state has in another contracting state.” For the purpose of preventing tax evasion, Romania stipulated a series of institutional mechanisms in the external conventions. This is also the case of the tax treaty concluded with Indonesia, which states that “if accompany of a contracting state conducts business activities in the other contracting state, having a permanent establishment in that state, in each contracting state, the permanent establishment shall be allotted the profits it might have realized if it had been a separate company, conducting identical or similar business under identical or similar circumstances and thus dealing independently with the company whose permanent establishment it is." An exception from the taxation regime corresponding to a permanent establishment under the OECD model is the treaty signed with Turkey, which states that "after the benefits of a company of a contracting state that conducts activities through a permanent establishment located there have been taxed in pursuance of this article, the resulting amount may be taxed in state of the permanent establishment according to the fiscal law applicable in that state, but the tax thus determined may not exceed 15%” (art. 7 par. 6).¹⁶

According to Romanian law, permanent establishment designates the location by means of which any activity of a foreign legal entity or natural person is entirely or partially conducted by means of a dependant agent.¹⁷

c) Taxation of international transport companies (article 8)

The profit resulting from international transport is dealt with in relation to taxation right, both in the model conventions and in the conventions concluded by Romania in a distinct article, usually article 8, whereas the typical aspects regarding taxation on profit obtained from this source in relation to the profit obtained from industrial, commercial, banking, etc. companies are taken into account. Most tax treaties

¹⁶ Published in the Official Journal no. 61 as per October 20th 1986.

¹⁷ Condor, *Drept fiscal. Evitarea dublei impuneri pe venit și pe avere*, p.59

concluded by Romania comprise the solution adopted by the OECD Model Convention regarding taxation right on the profit obtained from the activity conducted by transport companies. The model convention adopted the criterion of the residence of international transport companies that was extended also to the profit obtained from the operation of railway and road vehicles. The extension of the OECD Model Convention solution takes into account that both profits obtained by a company of a contracting state from the operation of ships aircrafts in international traffic and profits obtained from the operation of railway and road vehicles fall under the provisions of the agreement for the avoidance of double taxation concluded by Romania with Great Britain, Denmark, Sweden, Norway, Jordan, Syria. The tax treaties concluded by Romania and Spain, Pakistan, Canada, Tunisia include derogations from the principle of taxation of international transport companies, exclusively in the state in which their management is located, meaning that the profit obtained from the operation of the means of transportation used for passenger and goods transport within the boundaries of a contracting state are taxable in that particular state, namely in the source state and not in the company's state of residence. Another derogation is provided in the tax treaties with Sri Lanka and India, which states that the profits obtained from the operation of ships in international traffic may be taxed within certain limits also in the contracting state in which such activity is conducted. In the case of India, this sum amounts to 2% of the entire sum obtainable from transport, whereas in the case of Sri Lanka it amounts to 2.50%.

d) ASSOCIATED ENTERPRISES (article 9)

For the taxation of associated enterprises, Romania and its contracting partners have chosen to deal with them separately in article 9, since this refers to the peculiarities implied by existing legal relations between certain undertakings, located in different countries but connected by certain interests. Some of the tax treaties concluded by Romania refer both to the right to amend the diminished profit and its adequate taxation by the fiscally prejudiced contracting state and to the obligation of the other contracting state to recalculate the tax amount owed by the undertaking that was registered with a profit higher than it was entitled to. In this sense, the second paragraph of article 9

provides that “if a contracting state includes in the profits of a company pertaining to that state and taxes accordingly the profits for which a company in the other state was subject to taxation in that other state and the profits thus included are profits that would have been attributable to the first contracting state, provided that the terms agreed between the two companies were identical to those agreed between two independent companies, the other state shall accordingly amend the tax amount established for these profits.¹⁸ This amendment also encompasses the other provisions of this convention and, if required, the competent authorities of the contracting states shall mutually advise each other. In a series of tax treaties, Romania has included the prescription term within the limits of which the profits of a company may be altered.¹⁹ For this purpose, a third paragraph was added to article 9. The respective period is the period provided by the national law, whereas it may not exceed 5 years from the end of the current year in which the profits that may be the object to such alteration would be obtained by a company of that state. In case of fraud, voluntary omission or carelessness, this limitation is not applicable.²⁰

e) Taxation of dividends (article 10)

Article 10 of the tax treaties concluded by Romania uses the notion „dividends” with a large meaning, indicating generally income resulting shares of usage rights, of mining shares, founder shares or other rights than debentures, from participation at profits and income resulting from equity shares subject to the same tax regime as income resulting from shares, in accordance with the tax legislation of the contracting state in which the company distributing the dividends is resident.²¹

The tax treaty concluded with Germany includes, beside the general text present in the OECD model, „also income resulting from participation to a commercial activity, acting in the capacity of silent partner, as defined by the Federal Republic of Germany, from prize bonds or loans entitling the creditor to partake in the debtor’s benefits, as well as from distributions on equity shares of investment funds.” In paragraph 2 of Article 10,

¹⁸ Condor, *Drept fiscal. Evitarea dublei impuneri pe venit și pe avere*, p.72

¹⁹ See the Convention signed with Canada and Switzerland.

²⁰For the texts of the tax treaties see Cojocaru/Frățean, *Evitarea dublei impuneri , acorduri și convenții încheiate de România*, Buc., Lumina Lex, 2002.

²¹ See, for instance, the Conventions signed with Israel, Croatia, Moldova, Greece, Indonesia.

most conventions concluded by Romania mention that taxation rights are granted only to the state that is the source of the dividends, namely the contracting state in which the company distributing dividends is resident. This right of taxation is however restricted, as the state of source of dividends is entitled to retain a tax equivalent with a certain percentage rate of the total amount of dividends distributed by the respective company. The percentage rate is not unitary, ranging from 10% as agreed in the conventions signed with the USA, France, Germany, Italy and Belgium and 15% in the case of Austria, Russia, Turkey, etc. Certain conventions include a series of derogations provided in paragraph 3, which state that the first two paragraphs shall not apply if the beneficiary of the dividends, being a resident of a contracting state, possesses a permanent establishment or a fixed base in the other contracting state, in which the company paying dividends is a resident, and the holding in respect of which the dividends are paid is effectively connected with that permanent establishment or fixed base. In this case, the provisions of article 7 become applicable.

f) Interest (art.11)

Generally speaking, article 11 of the conventions concluded by our country stipulates that the notion “interest” indicates the income resulting from any kind of debts, accompanied or not by hypothecary securities or by a clause of partaking in the debtor’s profits and, in particular, income from public effects (funds) and income from debentures or debt securities, including bonuses and premiums connected to these effects, debentures and debt securities, as well as income assimilated to income from borrowed amounts, in accordance with the tax legislation of state generating the income. Paragraph 1 of Article 11 states that the interests generated by a contracting state and paid to a resident of the other contracting state are taxed in the second contracting state, namely in the creditor state, in particular, the destination state of the interests. Paragraph 2 of Article 11 imposes the taxation right of the source state, namely of the state that generates the interests. The agreements concluded by Romania comprise the solution of acknowledging the taxation right in the country of source of interests; however, in many cases this right is restricted by deviation from the two solutions provided in paragraphs 1 and 2 of Article 11. Thus,

this right is no longer granted if: the loans are granted, secured or guaranteed or received by the government of a contracting state, a political subdivision, a public entity or a governmental agency; loans are granted or received by the banks designated in the agreements; the beneficiary of the interests is an institution that is not subject to taxation on income, etc. The provisions of paragraphs 1 and 2 shall not apply if the person beneficially entitled to the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated in that other State, or performs in that other State independent personal services from a fixed base situated in that other State, and the holding in respect of which the dividends are paid is effectively connected with that permanent establishment or fixed base. In that case the provisions of Article 7 or Article 14, as the case may be, shall apply.

g) Commissions

This income class has not been dealt with in the model conventions. As a consequence of the persistent demand of the Romanian party, a large number of the tax treaties concluded by Romania have separately regulated this income category in article 12 or 13, as agreed by the contracting states. The term "commission" as used in these agreements means a payment made to a broker, a general commission agent or to any other person assimilated to such a broker or agent by the taxation law of the Contracting State in which such payment arises. Other agreements concluded by Romania use a brief definition, considering that commissions refer to "the payments made to any person for the services performed as a representative" or the "remunerations paid to any person for the services performed as an agent". These two rather condensed definitions state that the term "commissions" does not include payments for the independent personal services mentioned under art. 15 or the personal dependent services mentioned under art. 16.

The first paragraph of article 12/13 states that taxation is made in the state of residence the beneficiary of commission. Paragraph 2 provides that taxation is made also in the contracting state where the commissions arise, namely their source state, according to the taxation law of that contracting state.

h) Capital Gains

The OECD Model and the Romanian tax treaties do not contain a definition of capital gains and, moreover, the term capital gains is only found in the heading of Article 13, while the paragraphs themselves only make reference to gains. The nature of capital gains has always been debated and there is no consensus on the characterization of capital gains as income. This is also reflected in the substantial differences among the various systems as to the tax regime applied to capital gains. In this context, the drafting of treaty provisions dealing with capital gains was certainly one of the biggest challenges in international taxation. The key for interpreting Article 13 can be found in the examination of the history of the article along with the evolution of the capital gains concept in various tax systems.²²

The Romanian tax treaties follow the OECD Model Convention. One of the most important issues in public discussion is related with the drafting of par. 4 in some tax treaties. According to the new tax treaty concluded with Austria “Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of immovable property situated in the other Contracting State, may be taxed in that other State”. The standard formula from the OECD Convention mentions that “Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.” A similar provision defined in the treaty with Austria can also be found in the treaty with Germany , in par. 2 , “Gains from the alienation of shares and similar rights in a company, the assets of which consist -- directly or indirectly -- principally of immovable property situated in a Contracting State, may be taxed in that State.” The purpose of the article is to avoid interpretation of the term “value” which is in Romanian tax legislation not defined. The tax treaty with Germany

²² See for details on art. 13, Simontacchi, *Taxation of Capital Gains under the OECD Model Convention: With Special Regard to Immovable Property*, Wolter Kluwer, 2007.

contains other paragraphs which are not mentioned in the OECD Model Convention. According to par. 5 and 6 “Gains from the alienation of any property other than that referred to in paragraphs 1 to 4, shall be taxable only in the Contracting State of which the alienator is a resident.” “Where an individual was a resident of a Contracting State for a period of 5 years or more and has become a resident of the other Contracting State, paragraph 5 shall not prevent the first-mentioned State from taxing under its domestic law the capital appreciation of shares in a company resident in the first-mentioned State for the period of residency of that individual in the first-mentioned State. In such case, the appreciation of capital taxed in the first-mentioned State shall not be included in the determination of the subsequent appreciation of capital by the other State.”

i) Royalties

Apart from certain peculiarities, the tax treaties concluded by Romania define the term "royalties" as payments of any kind received as a consideration for the use of, or grant of the right to use, any copyright of literary, artistic or scientific work including copyright of motion picture films or films or tapes used for radio or television broadcasting, any patent, trademarks, design or model, plan, secret formula or process, or for the use of, or grant of the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience. Some of the treaties concluded by Romania discriminate between cultural royalties and industrial royalties.

The treaty signed with the US gives the following definition to royalties:

(a) Cultural royalties are payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, including copyrights of motion picture films or films or tapes used for radio or television broadcasting;

(b) Industrial royalties are payments of any kind made as consideration for the use of, or the right to use, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or for knowledge, experience, or skill (know-how);

(c) Cultural royalties and industrial royalties include gains derived from the sale, exchange, or other disposition of any such property or rights to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition of such property or rights.

Taking into account that the conventions concluded by Romania follow the OECD Model Convention also in what royalties are concerned, we hereby make reference to the OECD Comments, as we consider they are applicable and usable in Romanian tax practice.

j) Independent professional services

The agreements for the avoidance of double taxation concluded by Romania tend to avoid giving a complete definition of independent professional services (free services), the explanation comprising merely a set of examples. Thus, in paragraph 2 or 3 of article 14/15 of the tax agreements, the term `independent professional services` includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. Therefore, the conventional practices of Romania and its partners have followed the OCED Model Convention with respect to the definition of the term.

k) Dependent professional services

Art. 15/16 of the tax agreements concluded by Romania regulate the taxation on income resulting from dependent professional services, namely from the remunerated activity carried out by a person who is a resident of a contracting state. As a general rule, the tax agreements concluded by Romania, have borrowed the norm included in the OECD Model Convention which states that remunerations for paid work ought to be paid in the sate in which the service is rendered, regardless of which state that is, namely in the source state of income.

l) Remunerations of administrators

According to article 17/18 of the agreements concluded by Romania, the remunerations drawn by members of the board of administrators or directors, of the boards of censors or trustees, as well as other similar remunerations paid to a resident of a contracting state by a company that is a resident of the other contracting state, may be taxed in the latter, namely in the state of source of the respective income. The rule provided in the OECD Model Convention regarding taxation of remunerations drawn by executive officers of companies according to the above mentioned method, was included in the agreements signed by Romania with Sri Lanka and India.

m) Artists and athletes

Article 18/19 of the tax treaties concluded by Romania establishes the taxation of income drawn by artists and athletes. As a rule, the respective treaties include in the notion „artists and athletes” all theatre, motion picture, radio or television artists and musicians, as well as athletes that draw income from personal activities carried out in the other contracting state.²³ A large number of treaties signed by Romania stipulate that income obtained by artists and athletes who are residents of a contracting state from activities performed in the other contracting state are mutual exempt from taxation, on the basis of the cultural agreements between the contracting states. Such provisions are included, for instance in paragraph 3 of art. 18/19 of treaties concluded by Romania with Japan, Great Britain, Sweden, Italy, Canada, Pakistan, Egypt, Cyprus, Morocco, Malaysia, Jordan, Sri Lanka, Yugoslavia, Turkey, Tunisia, China, Greece, Costa Rica, Ecuador, Kuwait, Nigeria, the United Arab Emirates, South Korea, the Czech Republic, Russia, South Africa, Algeria, Lebanon, Uzbekistan. Certain tax treaties stipulate that such income drawn from the performed activities, on the basis of bilateral cultural agreements, be taxed in the sender state, namely in the state of residence of the beneficiaries of

²³ Lang, *Der Begriff der unselbständigen Arbeit nach Art 15 OECD-MA* (gemeinsam mit Mag. Ursula Zieseritsch) in: Gassner/ Lang/ Lechner/ Schuch/ Staringer (Hrsg) *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen 2003*, p. 31 ff.

income. This is the case of tax treaties concluded by Romania and Germany, Belgium, Denmark, Austria, Spain, the Netherlands, Syria.

n) Public offices

According to article 19/20, paragraph 1, of the treaties concluded by Romania, such remunerations are subject to taxation only in the contracting state in which the payment is made, namely in the state of source of income. By derogation from the previously mentioned rule, such remunerations may only be taxed in the other contracting state, namely in the state of residence of the beneficiary of income, provided that the services are rendered in that state and the person is a resident of that state, or the person is a national of that state; or the person has not become a resident of that state solely for the purpose of rendering the services.

Usually, paragraph 2 of article 19/20 of the tax treaties concluded by Romania regulates taxation on public pensions.²⁴ Accordingly, any pension paid by or from funds set up by a contracting state, an administrative-territorial unit or a local authority of that state to a natural person as compensation for the services rendered to that state, to a unit or an authority of that state, shall be taxed in that state only, namely in the source state. However, such pensions shall be taxed only in that other contracting state if the person is a resident and a national of that state, namely in the state of residence. The treaty concluded with Egypt stipulates (art. 20 paragraph 2) that the provisions regarding taxation on remunerations for certain public offices apply correspondingly to the remunerations paid by postal, railway, telephone, telegraph, radio television organizations and by the central bank of each contracting state.

o) Teachers and researchers

The OECD Model Tax Convention does not include an article dealing specifically with visiting teachers and researchers. The reason why some tax treaties have a separate article that provides a tax exemption in the state of source (“state of visit”) for such

²⁴ Mosteanu, *Dubla Impunere*, Ed. Didactica si Pedagogică, București, 2004, p.40

individuals is to stimulate the cross-flow of academics, not so much to allocate taxing rights between the contracting states.²⁵

In Article 20/21 of the agreements regarding the avoidance of double taxation concluded by our country, this income class is a standalone class with regard to taxation. Accordingly, a person who is a resident of a contracting state, temporarily visiting the other contracting state, at the invitation of the authorities of that state, or of a university or another educational institution acknowledged by the contracting state, for the purpose of teaching or carrying out research at a university or other educational institution in that State, shall be exempt from tax in the first-mentioned State on any remuneration for such teaching or research for a period not exceeding two years from the date of his visit to that State for that purpose. These provisions shall not apply to income resulting from research, if such research is not carried out for the public interest, but mainly for the benefit of private individuals. Consequently, income drawn by a teacher or researcher of a contracting state who carries out such activities over a limited period of time in the other contracting state shall only be taxed in the state of residence. In this sense, most tax treaties concluded by our country stipulate the tax exemption of income obtained from teaching or research in the state in which such activity is carried out (the host state), the exemption being granted for a period not exceeding two years.

To qualify for the exemption in the state of visit, the individual must be resident in the other contracting state immediately before making the visit. One issue is whether the exemption applies only to an individual who remains resident in his home state or becomes a resident of the state of visit during the period of the visit or whether the exemption also applies to an individual resident in neither of the two states. The latter view implies that the article is not subject to the restriction in Art. 1 (Persons covered) of the OECD Model in the absence of express wording to the contrary and is supported by the fact that the OECD Model itself contains provisions, such as Art. 24(1), that extend treaty benefits to a third-state resident.²⁶ The visit must be at the invitation of a university, college, school or other similar educational institution that is recognized by the

²⁵ Baker, *Double Taxation Conventions and International Tax Law* London: Sweet & Maxwell, 2nd ed., 1994, p.344.

²⁶ Hattingh, *Article 1 of the OECD Model: Historical Background and the Issues Surrounding It*, 57 *Bulletin for International Fiscal Documentation* 5 from 2003, p. 215.

competent authority in the state of visit. In the absence of a treaty definition, the word “invitation” takes its ordinary meaning in the state applying the treaty. The visit must be solely for purposes of teaching or research or both at an educational institution. Because of the word “solely”, it is not clear whether an academic who concurrently takes up an advisory or consultancy engagement for a government or private organization or statutory board would lose the exemption altogether. Such work is likely to complement and relate closely to his teaching or research, and this is particularly so if taking up such work is an expectation of the educational institution that engaged him. The individual’s remuneration for teaching or research is considered to remain eligible for the exemption, but the income derived separately from the advisory or consultancy work is not exempt under the teachers and researchers article because the work is not performed at an educational institution. As a practical matter, although this is not strictly necessary from the wording, the educational institution would be the payer of the remuneration, and the teaching or research or both would be conducted for (and not only at) the institution as well. A separate paragraph is usually included in the teachers and researchers article which provides that income from research will not be exempt in the state of visit if the research is undertaken, not for the public interest, but primarily for the private benefit of a specified person or persons. The public or public interest will be analyzed from case to case. Generally, the teachers and researchers article does not require that the source of the payment be outside the state in which the teaching or research is done.

p) Pensions and annuities

Most treaties concluded by Romania follow the rules included in the OECD Model Convention, establishing merely the allotment of the taxation rights.²⁷

Certain tax treaties define the main notions used in the respective treaties. Thus, the treaty concluded with Kuwait defines (art. 18 paragraph 2) the following terms:

- a) "pensions and other similar remunerations" means periodic payments made by reason of retirement, in consideration for services rendered, or by way of compensation paid after retirement for injuries received in connection with past employment.
- b) "annuities" means stated sums paid periodically at stated times during life, or during a specified or ascertainable number of years, under an obligation to make the payments in return for adequate and full consideration.

Other treaties concluded by Romania also include certain peculiarities. The treaties signed with Jordan and Zambia deal separately with pensions from private funds, social insurance pensions and public funds pensions. The treaty concluded with the US stipulates (in art. 16) that pensions and other similar remunerations from private funds are taxed only in the state of residence of they beneficiary; Payments for social insurance and another public pensions are tax exempt in both contracting states (art. 17),the treaty signed with Morocco provides that (art. 19 paragraph. 3) that life pensions or other pensions received by a resident of a contracting state are taxed only in that state, namely in the state of residence of the beneficiary.

q) Students, interns and trainees

Using the recommendations provided in the OECD and UNO Model Conventions, as well as the comments on the recommendations made by renowned experts, Romania has agreed, together with the states participating at the negotiations, to grant certain very

²⁷ See more in Lang, *Public Sector Pensions and Tax Treaty Law*, in: Gutmann (ed) *Liber amicorum* in honour of Cyrille David,p. 223 ff.

significant relief with regard to the taxes on income drawn by students, interns and trainees, for the period of their studies, professional training or education abroad. Such relief is in fact tax exemption. The treaties concluded by Romania provide, as a rule, that a student, business apprentice or trainee who is, or was immediately before visiting a Contracting State, a resident of the other Contracting State and who is present in the first-mentioned Contracting State solely for the purpose of his education, training or obtaining special technical experience shall be exempt from tax in the first Contracting State with respect to payments received from abroad for the purpose of his maintenance, education, or study. The same tax exemption is applicable for a limited period of two years for income received by such individuals for paid work in the first Contracting State, carried out for the purpose of supplementing their financial means for maintenance, education, study and research.

r) Other income

In order to ensure the effective implementation of the tax treaties and to determine the allotment of the taxation rights on certain income categories that were not regulated in these treaties, article 23 was inserted. In pursuance of the OECD Model Convention, most treaties concluded by our country provide that the income elements of a resident of a contracting state which have not been dealt with in the articles of the treaty are only taxable in that state, namely in the state of residence of the beneficiary of income. The regulation provided in this article has a subordinate character, since it is only applicable if the convention does not regulate (in another article) the taxation rights with regard to certain income categories that were not defined within its framework.

4. Methods to Avoid Double Taxation

The tax treaties concluded by Romania employ the two methods of avoiding double taxation, namely the exemption (exception) method and the credit (taxation) method, each having two variants with certain peculiarities that are regulated in the Model Conventions. As is the case of the articles regulating the allotment and tie-

breaking of taxation rights, the interests of the signatory states were the prevalent factors that lead to the use of certain methods of avoiding double taxation. Consequently, one may notice that Romania did not have a constant position, meaning that the method used was not the same with all contracting states. Moreover, even mixed solutions (or combined) were adopted, such as ordinary settlement for certain income categories (royalties, interests, dividends, etc.) and progressive exemption for other types of income. Most often, our country opted for the credit method with its variants. Thus, the total credit method was employed in the treaties concluded with Canada, Belgium, the Netherlands, Denmark, Finland, Norway, Jordan, Zambia, Pakistan, Sri Lanka, Syria, the Philippines.

The method of ordinary credit was used, for example, in the treaties signed with the USA, Germany, France, Japan, Great Britain, Italy, Sweden, Spain, Malaysia, Turkey, Tunisia, China, Russia, South Korea, the United Arab Emirates, South Africa, Switzerland, Thailand, Greece, Ecuador, Poland, Hungary, Uzbekistan, Armenia, and Yugoslavia.

Mixed solutions, namely ordinary credit and partial exemption were applied in the treaties signed with the Slovak republic, Algeria, Croatia, the Ukraine, Moldova. However, in the treaties concluded by Romania, total exemption does not appear as a firm solution, but only as a solution from which the state of residence may grant derogation, namely apply the progressive exemption method.

By analyzing the methods for avoiding double taxation and the content of the adopted articles, we may conclude that Romania has employed a great variety of solutions in this respect.

Academic Iulian Văcărel explains this lack of symmetry by the fact that until 1990, Romanian state undertakings participated at the formation of budget income by payments from benefits established through the residual method. Under these circumstances, the method of avoiding double taxation provided in the treaty did not have any practical significance for our country. Now that tax contributions of legal and natural persons have been altered, we need to conduct a critical analysis of the tax treaties concluded by our country up to 1990 that feature asymmetrical solutions, for the purpose of reconsideration and amendment if deemed necessary. Until 31 December 2010, a

four-year transitional period also applies in respect of the Interest and Royalties Directive.²⁸ During this transitional period, the rate of withholding tax on payments of interest or royalties to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State cannot exceed 10%.²⁹

5. Other Provisions

Non discrimination rule

The prevention of discriminatory taxation is an important role of tax conventions. Tax treaties, however, recognize that residents and non-residents are in a different situation and must often be treated differently for tax purposes. For this reason, the principle of non-discrimination has been carefully incorporated in tax conventions through a set of provisions that are found in Article 24 of the OECD Model Tax Convention. How the OECD pointed out, the differences and complexity of modern legal arrangements and tax systems sometimes mean, however, that it is unclear whether a distinction made by a country for tax purposes constitutes a form of discrimination that violates the provisions of Article 24 or a legitimate distinction that is not contrary to these provisions. The tax treaties concluded by Romanian authorities include the Non discrimination paragraph from the OECD Model Convention.³⁰ There was no discussion or dispute with the partner countries regarding the interpretation of art. 24.³¹

Amicable settlement

The first paragraph of the article usually refers to the situation in which an individual considers the measures taken by one or both contracting states ensue or may ensue a

²⁸ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

²⁹ For ECJ Case-Law see Lang, *Die gemeinschaftsrechtlichen Rahmenbedingungen für "Exit Taxes" im Lichte der Schlussanträge von GA Kokott in der Rechtssache N.*, SWI 2006, 213 ff.

³⁰ Lang, *Die Arbeiten der OEEC und der OECD zur Schaffung der Diskriminierungsverbote*, in Schuch/Staringer (Hrsg) *Die Diskriminierungsverbote im Recht der Doppelbesteuerungsabkommen*, Linde Verlag Wien 2006, p. 31 ff.

³¹ See more under OECD, APPLICATION AND INTERPRETATION OF ARTICLE 24 (NON-DISCRIMINATION), Public discussion draft, 3 May 2007, CENTRE FOR TAX POLICY AND ADMINISTRATION, <http://www.oecd.org/dataoecd/59/30/38516170.pdf>

method of taxation that is not in accordance with the treaty; regardless of the legal remedies provided by the national law of both states, that individual may submit his case for consideration to the competent authority of the contracting state of which he is a resident or a national, as the case may be. The wording of the law deals with the exercise of the right within 3 years from the first notification regarding the incongruity between the taxation method and the treaty provisions. According to the second paragraph of the article, the competent authority is liable to find an appropriate solution, provided the claim is deemed reasonable, namely the competent authority is liable to solve the problem by way of an amicable settlement with the competent authority of the other contracting state, for the purpose of avoiding taxation contrary to the treaty provisions. Furthermore, paragraph 3 of the tax treaties states that the competent authorities of the contracting states shall endeavor to resolve any difficulties or doubts that may arise from the interpretation of the treaty by way of mutual agreement. Romania has not yet formally ratified the EC Arbitration Convention.

Exchange of information

Paragraph 1 of article 27 (or 28, as the case may be) of the treaties concluded by Romania, include the following regulation: “The competent authorities of the contracting states shall exchange information if this be necessary for the implementation of the provisions of the present treaty or of the internal laws of the contracting states regarding taxes regulated by the treaty, provided taxation is not contrary to the treaty.” Moreover, paragraph 1 of article 27/28 of the tax treaties states that the receiving state and its bodies are liable to handle such information with secrecy, as well as to determine the terms and limits of its use. The Mutual Assistance Directive has been transposed into the Romanian Tax Code with effect from 1 January 2007. In particular, the domestic provisions corresponding to the Mutual Assistance Directive set out guidelines regarding the exchange of information between the tax authorities of the Member States (exchange on request, automatic exchange and spontaneous exchange) and clarify that the Romanian competent authority for the purpose of the exchange of information provisions is the Ministry of Finance or its authorized representative. In the same purpose, the legislator

included in the Tax Code the Commission Decision 98/532/EC from the 8th of July 1998 concerning certain measures necessary for carrying out activities related to communication and information exchange systems and to linguistic training tools under the Fiscalis programme (European Parliament and Council Decision No 888/98/EC establishing a programme of Community action to improve the functioning of the indirect taxation systems of the internal market).

Administrative assistance

Treaties concluded between certain states regulate “administrative assistance”, which in fact refers to tax collection in the other contracting state. The procedure regarding “assistance in collection” or “administrative assistance” is highly significant, since it ensures enforcement, including collection and remittance of taxes and other tax rights pertaining to Romania, on the territory of the contracting state, namely of the foreign state.

Diplomatic agents and consular officers

Articles 28-29 of the conventions concluded, state that nothing in this convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements. This general regulation is also included in the conventions concluded by Romania with other states. In most of these conventions, the first paragraph of article 29/30 provided for the necessity of ratifying the convention and the exchange of diplomatic instruments.

III. Underlying Policy Considerations

1. The Selection of Tax Treaty Partners

Romania had a series of tax treaties with other countries before 1989. There were no preferred tax treaties partners but the economic activities were conducted especially, in the 80-th with countries from the communist block. There is no special list of countries which would not be accepted as tax treaty partner.

2. Tax Treaty Policy Considerations over Time

The Romanian general policy toward tax treaties is to avoid double taxation, prevent fiscal evasion and strengthen substantive relations. The tax treaties that the Romania has entered into follow the OECD model and take into consideration matters relating to the political and fiscal status, economics, and trade of the mutual parties.

The Romanian policy on concluding treaties for the avoidance of double taxation is largely in line with the principles laid down in the OECD Model Tax Convention. From the point of view of tax treaty policy, there is no important difference from the period before 1989. Some of the treaties were amended due to the time difference and not because of a significant change of philosophies. The reason from the deviations from the OECD Model Convention is linked with specific interests of the Romanian government and the specific public agenda. An important interest is showed to the professor and researchers who benefit from the residence rule. Romanian negotiating policy in this regard has to be seen against a background of net revenue flow out of the country and a significant government budget deficit, together with a policy of encouragement of foreign investment. Accordingly, the policy seeks to establish higher rates of withholding tax that may be levied in the resident country. Romania seeks to conclude treaties with all significant business partner countries except tax havens.

3. The Influence of the Accession to the European Union

The EC Parent-Subsidiary Directive had already been implemented in the Romanian Tax Code prior to Romania's accession to the European Union, but only

applies from 1 January 2007.³² The Directive applies to dividends paid both between company's resident in Romania and between company's resident in Romania and company's resident in other Member States.³³ For the provisions of the EC Parent-Subsidiary Directive to apply, the minimum shareholding required by the Romanian law is 15% (to be reduced to 10% from 1 January 2009) with a minimum holding period of two years. If at the time of a dividend payment from a Romanian company to a qualifying EU parent, the two-year holding period has not been satisfied, the withholding tax exemption can still apply as long as the shares continue to be held after this date for sufficient time so as to enable the two-year holding period to be satisfied. In this case, however, the withholding tax must be paid and, once the two-year holding period has been satisfied, the tax paid can be reclaimed. The provisions of the EC Merger Directive (as amended by Directive 2005/19/EC) have been implemented into the Romanian Tax Code, with effect from 1 January 2007. The provisions apply to both reorganizations between domestic companies and to cross-border reorganizations involving companies resident in Member States. Accordingly, the merger of a Romanian company with an EU company should, in principle, be tax neutral in the same way as is a merger between two Romanian companies. In practice, it is, however, difficult for a cross-border merger involving a Romanian company to be effected, as Romania's domestic legal provisions governing mergers have not been updated to reflect the implementation of the EC Merger Directive. A potential method to achieve such a merger, but which only applies in limited cases, would be the conversion of the Romanian company into a European Company (*Societas Europaea*), the seat of which could then be transferred from Romania to a different Member State so that the merger could be carried out. The Interest and Royalties Directive is intended to eliminate withholding tax on qualifying interest and royalty cross-border payments between related parties. In Romania, the Interest and Royalties Directive has not yet been implemented into domestic legislation. According to the provisions of the Accession Treaty to the European Union signed by Romania, following Romania's accession but, at the latest, by 1 January 2011 (the date on which the Interest and Royalties Directive will become applicable in Romania), a 10% maximum

³² Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

³³ *Chiliment*, EU Accession and the Romanian Tax System, European Taxation nr. 5/2007, p. 249-253.

withholding tax rate will apply to interest and royalties originating from Romania if the recipient holds at least a 25% shareholding in the income payer for a minimum holding period of two years, unless the income earner benefits from a more favorable rate under a tax treaty in force between Romania and the Member State in which the beneficiary has his fiscal residence . If at the time the interest or royalty payment is made, the two-year holding period has not yet been satisfied, the withholding tax exemption can still apply if the shares continue to be held for sufficient time to enable the two-year holding period to be satisfied. In these circumstances, however, the withholding tax must be paid and, once the two-year holding period is satisfied, the tax paid can be reclaimed. From 1 January 2011, interest and royalties paid by a Romanian company to an associated EU company (i.e. at least 25% direct ownership, with the recipient being either a direct subsidiary or a direct parent or owned by a common direct parent) will not be subject to withholding tax. The ECJ's decision in *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV* has been implemented into Romania's domestic legislation via the Norms for the application of the Fiscal Code and, therefore, the two-year period required for the exemption from Romanian withholding tax in respect of dividend, interest and royalty payments to an associated enterprise should be interpreted in the light of this ruling.³⁴

4. The Influence of Domestic Law

The domestic law plays not such an import role in defining the tax treaty policy. In most of the treaties there is a clause underlining that there is no source taxation under tax treaty law in cases where Romania could not exercise taxing rights under domestic law (because no source taxation). There is no specific requirement to insert in Romanians treaties specific articles. The specific paragraph regarding professors and researchers is a specific of Romania tax treaty. Romania is a very interested in stimulating investments. Treaties can increase investment in several ways. First, they work to offset the double

³⁴ *Chiliment*, European Taxation 2007, p.253.

taxation of foreign-earned profits. They do so by governing double taxation relief methods, reducing the withholding taxes, and coordinating definitions and jurisdictions across borders. In addition to this, treaties can reduce tax uncertainty. Treaties also reduce uncertainty by providing rules for dealing with tax conflicts between governments and between governments and firms. Since uncertainty can be a major barrier to investment, simply reinforcing and formalizing the tax environment can encourage investment. While some authors suggested that treaties simply require tax harmonization and elimination of deductions to reach efficiency, recent studies from Romania find limits to treaty improvements due to the above-mentioned differences in preferred harmonized tax rates, in the perspective of the European discussions about a common European tax.³⁵

5. Relevant “Players”

The Ministry of Economy and Public Finance participates, on behalf of the state, domestically and abroad, as the case may be, in the international negotiations regarding the bilateral and multilateral agreements for promoting and protecting investments, conventions on avoiding double taxation and fighting tax evasion. The ministry plays the most important role in negotiating the tax treaties. Specific departments from the Justice Ministry are also involved in the negotiation. The legislative body, the Parliament does not interfere with tax treaty policy. The role of the Parliament is to approve the tax treaties. The role of the Parliament is in practice only a formal one. There was no plenary discussion on the issue in the Parliament. The debates are concentrated on the domestic tax policy. There is a strong dispute pro and against the flat tax. The business sector sustains their opinions before the Economic and Social Committee, a consultative body gathering the representatives of the government, trade unions and business representatives. They express their problems and try to sustain their point of view. Romania does not have a “model treaty” , and there are also no critical public debates on

³⁵ Miff/Păun, *Dreptul Afacerilor*, Ed. Imprimeriilor Ardealul, Cluj-Napoca, 2006, p. 112, Gyula, *Drept instituțional comunitar*, Ed. Sfera Juridică, Cluj-Napoca, p.47.

the drafts of the tax treaties. Only in the academic life, there are often discussions on the main trends of the development of the Romanian tax policy.³⁶

IV. Future Developments

The Romanian tax treaty network continues to expand. The country currently has concluded 77 treaties, 4 of which are still under negotiation or require approval from the Luxembourg or the foreign country Parliament. The agreements generally cover income tax, corporation tax and capital gains tax (direct taxes). The Romanian tax treaty network is an important part of the country's framework for international trade. Bilateral treaties play a critical role in bringing certainty to the global marketplace and safeguarding multinational businesses from the threat of double taxation. From a qualitative point of view, we can argue that the Romanian specialists were interested to keep the general provisions of the OECD Model Convention. From a quantitative point of view, Romania has a big network of treaties in a comparison with other European countries. There is a need to develop treaties with other countries from other parts of the world where there is a potential of business with Romanian companies. In respect of the relations with the most important countries in the economic field there is a need to redefine the WHT tax and to struggle for a harmonization of taxes within the European Union. The recent experience of Romania shows a strategy of negotiation of new treaties.

Looking forward, Romania will join in future the common European strategy in the tax treaty policy. The ministry of Economy and finance is waiting for a common position of the other EU countries regarding the question how the member states will combine fundamental freedoms and tax treaties between the countries. The future case-law of ECJ will tend to abolish the tax treaties between the EU member states and the institutions will try to develop a common tax policy. This is a realistic point of view from the perspective that the member states will want to continue the European integration process. The Governmental perspective seeks to find other partners that could be interesting for Romanian companies.

³⁶ Miff/Păun, *Dreptul afacerilor*, p.345.