

GROUPS OF COMPANIES. COUNCIL DIRECTIVE ON THE COMMON FISCAL REGIME APPLICABLE TO PARENT COMPANIES AND THEIR SUBSIDIARIES IN VARIOUS MEMBER STATES (90/435/EEC). THE IMPLEMENTATION OF THE COMMUNITY REGULATION IN ROMANIA

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ABSTRACT: *„The more, the stronger” is an old saying frequently used by people who face difficult situations and who, in order to reach their objectives, adopt the method of uniting their own forces with those of other persons having the same interests, aiming at accomplishing a common goal in the framework of an association, precisely within a group of interest.*

In this system, groups of companies have now become an economic reality and an immediate necessity, simultaneously with the advanced decentralization of services and production activities.

In order for the undertaking to be less vulnerable and, at the same time, as efficient as possible, the general trend is to set up associations entered into by establishing relations with other undertakings which are not necessarily of a legal nature. This process may either be based on the acquisition of control, or on the formation of other companies.

KEYWORDS: *decentralization, “parent company”, group of companies, community regulation, fiscal regime*

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1. „The more, the stronger” is an old saying frequently used by people who face difficult situations and who, in order to reach their objectives, adopt the method of uniting their own forces with those of other persons having the same interests, aiming at accomplishing a common goal in the framework of an association, precisely within a group of interest.

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In order for the undertaking to be less vulnerable and, at the same time, as efficient as possible, the general trend is to set up associations entered into by establishing relations with other undertakings which are not necessarily of a legal nature. This process may either be based on the acquisition of control, or on the formation of other companies.

The genesis of such groups is closely related to the development strategy of the undertakings. Consequently, the diversification and extension of the production, as well as

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the access on other markets bring about the possibility of an organizational system which either maintains the legal structure of the company or organizes economic departments and sets up specialized subsidiaries – having a distinct legal personality – but strictly controlled by their parent company which has the right to regroup identical, similar or complementary economic activities.

The creation of such groups is connected to the acquisition of profit-sharing bonds. The possession of such bonds derives from performing a wide range of operations, such as: subscription of the shares issued by new-born companies, participation in the capital uplift or the acquisition of bonds issued by existing companies or firms.

The group – based on the concepts of power and control – comes into being in order to make use of the fiscal or financial advantages, neutral and common on Community level.

When such groups of companies are very concentrated, one company has, in fact, the economic power. Consequently, there are two types of companies:

- the company known as “group leader” or “parent company”, developing a commercial activity in relation with other companies, “subsidiaries”, in which it owns shares,
- the parent company is a holding company, whose assets are made up of profit-sharing bonds in other companies and whose goal is to manage this portfolio.

Based on the data made available by the accounting departments of various companies, all part of the same economic group, summary reports are drawn up for the group as a whole. These reports are called consolidated accounts which normally comprise a consolidated profit and loss account, a consolidated balance sheet or a consolidated annex. The consolidation of the accounts aims at showing the patrimony, the financial situation and the accounting results of the entities within the consolidation area, as a whole. In order to consolidate the accounts, the first step is to delimit the undertakings belonging to the group. In other words, it is necessary to determine the consolidation area. The consolidation operations involve the preliminary adjustments of individual accounts, cumulating individual accounts, elimination of mutual accounts and operations and elimination of the internal results of the group.

2. In the European Union, the existence of a taxation policy is crucial. As a consequence of the organization and functioning of the Community as a whole, the individual legislative initiatives of each country have an impact both on the territory of the country in question and in the other member states.

In the past, the differences among the taxation rates stipulated by the internal legislation of the countries used to influence commercial activities, whereas taxpayers moved their residence from one Member State to another Member State, where the regime was more tolerant, in order to reduce their tax burdens.

The fiscal provisions regulating the relations among the parent companies and their subsidiaries, existing in various Member States, are significantly different from one state to another, thus preventing Community economic cooperation. Thus, the introduction of a common fiscal regime was a must. Its objective is to encourage company grouping on Community level in order to assure the creation and good functioning of the common market.

The creation of the Common Market and the completion of the Economic and Monetary Union determined new Community initiatives taken in the field of taxes and duties. The

abolition of restrictions on the free movement of capital stirred fears and, together with the tax burden, has affected employment and social protection. Consequently, the European Community has several objectives with a view to building up a general taxation policy. One of the long-term objectives aims at the prevention of the differences between the indirect taxation rates and those of the taxation systems capable of causing distortions of the competition within the Single Market. As far as direct taxation is concerned, the goal is the implementation of fiscal neutrality, meaning by that the elimination of the legislative ambiguities which resulted in tax evasion and double taxation.

The Treaty establishing the European Community does not comprise any explicit provisions on the harmonization in the field of direct taxation. The explanation is that, to the greatest extent, direct taxation doesn't need to be harmonized, as it is applicable strictly within every Member State. As a result, most of the provisions on direct taxation are entirely taken care of by the Member States, being an indicator of their sovereignty. Fiscal regulations on direct taxation are established by each Member State, depending on their necessary resources, on their traditions, on the typology of the operations undertaken, etc. Nevertheless, direct taxation could affect the four fundamental freedoms necessary to create and preserve the European Union, respectively: freedom of movement for persons, goods, services and capital.

The occurrence of special situations, such as double taxation or transboundary economic activities, demanded the implementation of common legislative measures in all Member States, applicable especially to the companies and adopted unanimously by the Council.

The measures in question were adopted in 1990 in the form of two directives and a convention. Directive 90/435/EEC is related to the abolition of double taxation of the profit divided between parent companies located in one Member State and their subsidiaries located in another Member State. Directive 90/434/EEC reduces the tax burden susceptible of hindering the reorganization of companies. Convention (90/436/EEC), based on Article 238 of the Treaty, introduces an arbitrary procedure to avoid double taxation regarding profit adjustment between associated undertakings located in different Member States.

Directive 90/435/EEC on a common taxation system applicable to parent companies and their subsidiaries – as well as the Directive on the mergers – was adopted on July 23rd 1990 and entered into force on July 30th 1990; it was transposed in the legislation of Member States until 01.01.1992. Known as the Subsidiary Directive, it was amended in 2003 and 2006.

This directive did not hinder the implementation of the internal provisions or of those based on agreements, both necessary to prevent fraud and abuse. Any company in a Member State owning minimum 20% of the capital of another company located in another Member State was considered to be a parent company. As from January 1st 2007, the minimum level was established at 15%, and as from January 1st 2009, the minimum level is 10%. The subsidiary is the company whose capital comprises the above mentioned participation.

3. Now, after Romania became a Member State of the European Union, the relevant authorities shall transpose the directives on common taxation into the internal legislation. Fiscally, it is more difficult to accomplish legislative harmonization compared to other fields

of activity, as the right to charge is a characteristic of the state's power. Consequently, all states are hard to convince when it comes to fiscal sovereignty. The accession treaties of all Member States which became members in 2004 and 2007 stipulate no transitional period in relation to the Subsidiary Directive, thus it needs to be immediately implemented. Romania is no exception to the rule. The implementing rule is to be found in the Tax Code, Article 20 α (The fiscal regime of the dividends received from the Member States of the European Union).

Article 20 α of the Romanian Tax Code mirrors in the internal law the provisions of the "Subsidiary Directive" on the EU level. The Directive aims at abolishing the taxation of such dividends paid from companies owned by other companies in the European Union, thus encouraging the creation of new subsidiaries through the europeanization of national companies, the increase of commercial cooperation and elimination of certain fiscal barriers within the Community. The implementation of Community provisions encourages the creation of subsidiaries which they themselves may create further subsidiaries beyond the borders of the states of origin, thus giving birth to multi-level companies. Becoming stronger and stronger, these companies develop new fields of activity. Should there be no such provisions, a corporate income tax would have been imposed on the dividend within the company it was allocated to, and this would have been equal to double taxation.

The taxation procedure is almost identical in case of the companies incorporated under the laws of Romania, having subsidiaries in Romania, being considered as non-taxable income - dividends- when the corporate income tax is calculated. In this respect, it is worth mentioning one of the latest amendments of the Romanian Tax Code which seems to have ignored the Community provisions in question. As a consequence, as far as the corporate income tax is concerned, Article 18 of the Fiscal Code as amended by the Government Ordinance no. 34 of 11.04.2009 (implementation date 1.05.2009) which introduced the minimum tax on the global income, should the corporate income tax calculated by using the 16% rate be lower than the minimum tax calculated for the corresponding global income recorded on December 31st the previous year.

4. The above mentioned amendment brings about the following problem: Romania implemented Directive 90/435/EEC on the common tax system applicable to the parent companies and to their subsidiaries from various Member States, as amended by Directive 2003/123/EC of the Council through the introduction in the Tax Code of Article 20 α / Act 343/17.07.2006; the Article entered into force when Romania joined the European Union (January 1st 2007). As shown before, its implementation requires that profit taxpayers should not be taxed on their dividend-related income; this is not the case with taxes imposed on the minimum profit because all kinds of income are taken into account when calculating the global income, with only some exceptions. We have to say that the types of income under Article 20 α are not explicitly considered exceptions, thus being calculated and taxed according to the new minimum tax.

One valuable recommendation would be to include dividend-related income in the category of the income left out when establishing the income rate, within the meaning of the Subsidiary Directive which is also mirrored in our internal legislation. Otherwise, Courts shall enforce the provisions of the Community law. Usually, Member States have the

obligation – under the Principle of loyalty to the Community and the Principle of law efficiency – to repeal the national legislation opposing the Community law. Nevertheless, under the circumstances, it is necessary to take into consideration the Principle of direct effect and the Principle of precedence of Community law as opposed to internal law – both consecrated by the Decisions *Costa vs. Enel* and *Simmenthal 2* – as Community law has precedence over any opposing provision in the national law. This does not invalidate the existence of the national law, but enforces the principle of precedence of European law.

5. Within the meaning of the Subsidiary Directive, if the parent company receives the distributed profit, the state in which the parent company is located should: not impose any taxes on these dividends or should tax the dividends, allowing the parent company to deduct from the total tax the amount paid by the subsidiary distributing dividends.

In order for the system under this Directive to be implemented, the parent company must own at least 15% (10% as from January 1st 2009) from the shares of the dividend-paying subsidiary. However, Member States are authorized to refuse offering these facilities in case the parent company has not obtained that percentage for two years in a row.

This Directive derives from a well-known situation of double taxation: each company must pay taxes on its corporate income, and then distributes dividends which are also taxed on the account of the associate/partner. To this end, the Directive firmly stipulates that „The dividends distributed by a subsidiary to its parent company shall not be taxed.” (Article 5), whereas „The Member State of the parent company cannot tax the profit received from a subsidiary” (Article 6).

The Directive covers both directions the relation coming into being between Member States, stipulating that neither one will tax such amounts. The national legislation transposing this Directive cannot exceed certain limits, regulating only the amounts under the internal taxation. This was the case in all Member States, including Romania:

“Article 20a - The above mentioned fiscal regime of the dividends received from the Member States of the European Union stipulates that, after the accession of Romania, the dividends received by a Romanian legal entity, namely a parent company, from one of its subsidiaries located in a Member State, are non-taxable dividends, should the Romanian legal entity pay corporate income tax, no other option or exception possible; should it own at least 15% of the share capital of a legal entity from a Member State, respectively at least 10%, as from January 1st 2009 and should it also own a share for two years in a row when it receives its dividend-related income.

This 2-year period should not be understood in absolute terms, especially taking into account that the Directive was construed by the Court of Justice of the European Communities. Thus, the Methodological Norms for the implementation of the Tax Code stipulate that the minimum 2-year period shall be understood as follows: should this requirement not be fulfilled when the dividend is taken into evidence, the dividend-related income is taxable. After two years (the requirement has been fulfilled), the taxpayer is in the position of having his corporate income tax recalculated starting with the year in which his income was taxed, by submitting an amending declaration on the corporate income tax.

In other words, even though the taxpayer is taxed during the first two years, he shall recover it in the third calendar year by means of recalculation. As a matter of fact, fiscal planning in the field of income distribution between affiliated companies has to be limited to the cases in which one of the relevant states is not a member of the European Union (non-EU state) or the project is no longer than 2 years, which is usually common for permanent business establishments, such as extractive activities, construction sites and montage projects.

In these two situations, we make use of the bilateral treaties regarding double taxation prevention, with a view to legal tax evasion – minimizing the taxes paid by using legal instruments.

Non-taxation of dividends aims at avoiding double taxation; these dividends are distributed from a corporate income already taxed, whereas the net profit is part of the accounting process of the share-owning company, with no further expenses. Consequently, the company owning profit-sharing bonds has already paid corporate income taxes, as well as dividend-related taxes. Given that, should the company owing the dividends pay once more the corporate income taxes, this would clearly be a case of double taxation.

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