
Developments and Thoroughgoing Studies on Taxation of Royalties Obtained by French Non-Residents in Romania

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Romanian tax legislation continues to contain contradictory provisions that give it a strong ambiguity and which often generates controversy in interpretation and application. The authors of the research show the situations of tax income from royalties obtained by a French non-resident from a Romanian beneficiary. Thus, are addresses the taxation from the perspective of (i) the law, (ii) the avoidance of double taxation (CEDI) concluded by Romania with other countries and (iii) the EU legislation. Also, the authors present one of the cases of controversy generated by the Romanian tax legislation, which create controversy and maintain a high level of uncertainty in the business environment.

Keywords: *royalty; French non-resident; income tax; double taxation convention; the most favorable rate; European legislation.*

JEL: *H32 - Firm; M41 - Accounting*

Introduction

According to the Romanian Fiscal Code - Law 571/2003, a taxpayer has the right to choose between applying domestic law in terms of tax revenues

obtained in Romania by non-residents, the double taxation conventions (CEDI) concluded by Romania with other states or EU legislation to apply a more favorable tax rate. The decision is up to the taxpayer, conditioned only by the contractual provisions on pricing and taxation of his payment, ended with non-resident partners.

Under these provisions a taxpayer Romanian legal entity that pays income to a legal resident in another EU member state can theoretically be found in one of the following cases:

Case 1 - Taxation with the tax rate stipulated in the Romanian tax legislation

Case 2 - Taxation with the tax rate provided in CEDI (if any)

Case 3 - Application of the provision of the EU legislation

For example we will analyze the hypothetical case in which a taxpayer SC R SA - Romanian legal entity, tax payers of corporate tax- pays a company F SA - French legal entity, paying the "impot sur les societies" - income from industrial royalties, French legal entity being the actual recipient of such income.

Under the agreement concluded between the parties the amounts stipulated in the contract are gross income, any taxes and / or tax obligations provided by law in such amounts being retained. In the contract there is no reference to Obligation of the French Provider to provide the Romanian beneficiaries' tax residence certificate "or other document attesting tax residence in France of the Provider F SA.

Taxation according to domestic tax legislation

Billing is done at the beginning of the month in equal monthly installments in the amount of € 1,000 and payment takes place in the same month. In November 2012, the French non-resident issue the invoice in the amount of Euro 1.000 non-taxable for VAT, as B2B rule applies, that the transaction is taxable in Romania and the Romanian beneficiary of the services is liable to pay VAT under the VAT self-liquidation mechanism.

Hypothesis 1: Income is taxed in Romania

Between the two companies there is no mutual holding of shares. Also, the provider F SA has not submitted to R SA the tax residency certificate (CRF) for 2012.

b.1.1) are taxable income in Romania?

According to article 115, para. (1) let. d) of the Tax Code, the taxable income obtained from Romania, whether revenues are received in Romania or abroad, are also the royalties from a resident.

b.1.2) who bears the tax on income obtained by the French non-resident?

Article 113 of the Tax Code states that non-residents who obtain taxable income from Romania have the obligation to pay tax under Chapter I of Title V of the Tax Code, being named contributors.

b.1.3) who pays income tax for the income obtained by French non-residents?

From art. 116 para. (1) of the Tax Code it shows that the beneficiary of the services-Romanian legal entity-, as a payer of income, has the obligation to calculate, withhold and pay tax to the state budget for the taxable income obtained by non-residents in Romania.

b.1.4), which is the tax base?

Tax revenues from Romania obtained by non-residents applies to the taxable gross income obtained from Romania, based on art. 114 of the Tax Code. Conversion into currency RON tax on income obtained from Romania in the form of industrial royalties is made at the exchange rate of the currency market by the NBR for the day in which the non-resident license fee is paid according to item 9 index 5 let. a) of the Rules for the application of art. 116 of the Tax Code.

b.1.5) which is the rate prescribed by the Tax Code?

According to art. 116, para. (2) let. d) of the Tax Code, the tax rate is 16%, applicable to gross income from Romania.

b.1.6) which is the accounting treatment in case of the withholding tax?

In these circumstances, the Romanian entity R SA will perform the following records:

- Recording royalty bill (issued on 01.11.2012)

612	=	401	4,564 lei
„Expenses with royalties, management and rentals locations”		„Suppliers”	(1.000 euro * 4,564 lei/euro)

- VAT auto-liquidation registration (4,564 lei * 24%):

4426	=	4427	1.095,36 lei
„Input VAT”		„Output VAT”	

- Registration of bill payment of November 25, 2012 (840 euro * BNR exchange rate 4,5313 lei / euro):

401	=	%	<u>3.833,76 lei</u>
„Suppliers”		5124	3.806,30 lei (840 euro * 4,5313 lei/euro)
		„Cash at bank in foreign currencies”	27,46 lei
		765	[840 euro * (4,564 - 4,5313) lei/euro]
		„Foreign exchange gains”	

- Registration of withholding income tax (160 euro * BNR exchange rate 4,5313 lei / euro):

401	=	%	730,24 lei
„Suppliers”		446	725 lei (160
		„Other taxes and similar liabilities”	euro * 4,5313 lei/euro)
		768	5,24 lei
		„Other financial revenues”	[160 euro * (4,564 - 4,5313) lei/euro]

Profit and Loss Account for the month of November 2012 is affected with 4.5313 lei (operating expenses of 4.564 lei minus financial income of 32,70lei).

- Recording of payment of income tax (20/12/2012) based on the payment order and Form 100 for the month of November 2012:

446	=	5121	725 lei
„Other taxes and similar liabilities”		„Cash at bank in lei”	

b.1.7) which is the accounting treatment in case of not withholding the tax at source?

In these circumstances, the Romanian entity R SA will perform the following records:

- Recording royalty bill (issued on 01.11.2012)

612	=	401	4.564 lei
„Expenses royalties, management and rentals locations”		„Suppliers”	(1.000 euro * 4,564 lei/euro)

- Registration of VAT self-liquidation (4.564 lei * 24%):

4426	=	4427	1.095,36 lei
„Input VAT”		„Output VAT”	

- Registration of bill payment of November 25, 2012 (1.000 euro * BNR exchange rate 4,5313 lei / euro):

401	=	%	<u>4.564 lei</u>
„Suppliers”		5124	4.531,30 lei (1.000 euro * 4,5313 lei/euro)
		„Cash at bank in foreign currencies”	
		765	32,70 lei
		„Foreign exchange gains”	[1.000 euro * (4,564 - 4,5313) lei/euro]

- Recording income tax (1.000 euro * BNR exchange rate 4,5313 lei / euro * 16/100-16)

635	=	446	863,10 lei
„Other taxes, duties and similar expenses”		„Other taxes and similar liabilities”	

In case of not withholding at the source, is considered that the sum paid to the French non-resident is the net income, which means that for calculating corporate tax the company R SA, as payer of royalty shall determine, by recalculation, the gross income to which would apply the tax rate in the domestic law (1,190.476 euro: 1.000 euro / (100-16/100)).

In case of not withholding at the source by the payers of royalty of the taxes related to income from Romania by non-residents, the costs recorded in the accounting records of the taxes paid to the state budget by legal residency - paying tax on behalf of the legal person - beneficiary of royalties are not deductible in calculating income tax, according to Art. 21, para. (4), let. a) of the Fiscal Code, read in conjunction with section 38 of the detailed Rules for the application of Title II of the Tax Code, as it is believed that Romanian resident suffered unduly a tax which is the responsibility of the French resident.

Profit and Loss Account for the month of November 2012 is affected with 5394.40 lei (operating expenses 5427.10 lei minus financial income of 32.70 lei).

- Recording of payment of income tax (20/12/2012) based on the payment order and Form 100 for the month of November 2012:

446	=	5121	863 lei
„Other taxes and similar liabilities”		„Cash at bank in lei”	

Hypothesis 2: Income is exempt in Romania

Company F SA sent to R SA the tax residency certificate (CRF) for 2012, given that it owns 01.06.2008 - 65% of the shares issued by R SA.

Article 117 let. j) of the Tax Code states that "are exempt from tax on income obtained from Romania by non-residents the following revenues: j) starting on January 1, 2011, income from interest or royalties, as defined in art. 124 index 19 obtained from Romania by legal persons resident in EU Member States [...] shall be exempt from tax if the beneficial owner of interest or royalties (entity F SA, nn) holds less than 25% of the value / number units of the Romanian legal person (entity R SA, nn) for an uninterrupted period of at least 2 years ending on the date of payment of interest or royalties ".

Because the two entities affiliated analyzed, Company F SA can benefit from income tax relief obtained in Romania, which means that the company R SA from Romania will pay to the French non-resident the entire bill, because it should not withhold an income tax of 16%. In this case, the accounting records are identical to the first three entries in section B.1.7) on the registration of the royalty bill, self-liquidation and payment in full of the invoice VAT by the French non-resident. The profit and loss account for the month of November 2012 is affected with 4531.30 lei (operating expenses of 4,564 lei minus financial income of 32.70 lei).

Hypothesis 3: Revenues are exempt from payment in Romania

Company F SA sent to R SA the tax residency certificate (CRF) for 2012. There is a third company, T SA that owns, since 2005, over 50% of shares (units) at each of the two companies F SA and R SA. In November 2012, industrial R SA pays royalties for the current month to F SA. Under the contract invoice value is 1.000 € (issued without VAT).

Residence is known and proven by the existence of CRF and the existence of T SA gives two companies F SA and R SA status of "associate" in the meaning of Art. 124 index 20 of the Tax Code. The two companies have organizational form "joint stock company (JSC)" for the Romanian legal entity R, respectively "Anonymous Company (AC)" for the French legal entity F SA.

According to art. 124 index 20 letters. a) of the Tax Code, in the purpose of this chapter "the term enterprise of a Member State means any company:

- i. to take one of the forms listed in this regard in the list referred to in art. 124 26 index, and
- ii. that, in accordance with the tax legislation of a Member State shall be regarded as resident in that Member State and is not considered for the purposes of a double taxation convention on income and on capital signed with a third country, as being a resident for tax purposes outside the Community, and
- iii. which is subject to the following taxes without being exempt from tax, or a tax which is identical or essentially similar and which is imposed after the date of entry into force of this Article, in addition or in place of those existing taxes [...] - - impôt sur les sociétés, in France [...]."

According to art. 124 index 20 letter. b) (iii) of the Fiscal Code "a company is an associated company of another company if, at least: (iii) a third company has a direct minimum holding of 25% both in the capital of the first company and in the one of the second. Participation capital must be owned only by company's resident within the European Community; Art 124 index 26 letter. f) of the Tax Code states that among the companies covered

by the provisions of art. 124 index 20 letter. a) (iii) are also the companies "known in the French law as" *société anonyme*, *société en commandite par actions*, *société à responsabilité limitée* and public entities and industrial and commercial enterprises."

The form of organization of those two companies (according to art. 124 index 26) with tax residence in the EU and the type of tax they pay (according to art. 124 index 20) describes the two companies in the category of companies of a Member State perspective of art. 124 index 20 letter a).

Thus, accumulating the quality of "associated companies" with the status of each of the "enterprise of a Member State" for economic transaction undertaken by the two companies may apply the provisions of article 124 index 18 of exemption from any tax on royalty payments arising from Romania, either through withholding or by declaring:

According to art. 124 index 18 par. (1) of the Tax Code "payments of interest and royalties coming from Romania are exempt from any taxes imposed on those payments in Romania, either through withholding or by declaration, provided that the beneficial owner of interest or royalties is a company from another Member State or a permanent establishment of an enterprise of a Member State in another Member State".

According to art. 124 index 18 par. (7) of the Tax Code "this Article shall apply only if the company is paying (in our case R SA, nn) or company whose permanent establishment is treated as the payer of the interest or royalties is an associated company of the company who is the beneficial owner (in our case, F SA) or whose permanent establishment is treated as the beneficial owner of those interests or of those royalties." Moreover, para. (10) of the same article cited above states that "the provisions of this chapter shall not apply to a company of another Member State or a permanent establishment of an enterprise of another Member State if the conditions laid down in art. 124 index 20 letter. b) have not been maintained for an uninterrupted period of at least 2 years. "

According to art. 124 index 18 par. (11) in conjunction with para. (13) of the Tax Code, it must be provided the evidence of meeting the requirements set on payment of royalties by a certificate valid for one year from the date of issue. Specifically, the company F SA will send the certificate which shall contain the following information: (i) proof of

residency in France for tax purposes, (ii) having the right of beneficial owner of the royalties, (iii) F SA is a company associated with R SA because it holds a 65% to R SA, since 06/01/2013.

In these conditions, the accounting records are identical to those of section B.2).

Case 2: Taxation according to the conventions for the avoidance of double taxation

The French non-resident F SA sent to the customer R SA the tax residence certificate (CRF) for 2012. From the data presented in case 1, because residency is known and proven by CRF, we believe that can be applied to the provisions of Article 118 Tax Code that limits the rate of tax to be withheld at the lower of levels provided by the Tax Code and CEDI in that the country, namely France when analyzed:

Article 118 par. (1) of the Tax Code, "[...] If a taxpayer is resident of a country in the European Union, the tax rate applying to taxable income derived by that taxpayer in Romania is the most favorable rate in the domestic law, EU law or double taxation conventions. EU legislation is applied in Romania's relations with the European Union Member States or European Free Trade Association."

Moreover, the "International Convention will apply only when internal law does not provide necessary or sufficient legal solution" (Costa, 2011, pg 248). In addition, CEDI object is to provide a unique formula for the taxation of taxable value transfer between the two signatory countries excluding the risk of being subject to double taxation [...]. Double taxation International tax is "submission to taxation of the same taxable materials and the same time by two different tax authorities of the two countries" (Gherghina, Cretan, 2012, pg.94).

Which are the provisions of the convention for the avoidance of double taxation?

Decree 240 of 27/09/1974 ratifying the Convention between the Socialist Republic of Romania and the Government of the French Republic for the avoidance of double taxation on income and wealth, says in Article 12 para. (3) the term "royalties" as "the term royalties as used in this Article means payments of any nature paid for the use or right to use a copyright in a literary, artistic or scientific work including cinematography films, any patent, a brand factory or trade, design or model, plan, a secret formula or process, as for use or right to use industrial, commercial or scientific equipment or for information having the character of experience in the industrial, commercial or scientific field."

The rule of taxation is found in art. 12 para. (1) CEDI "Royalties arising in a Contracting State (Romania, nn) paid to a resident of the other Contracting State (France, nn) be taxed in that other Contracting State (France, nn)".

However, is applicable, without exception to art. 12 para. (2) CEDI: "However, such royalties may be taxed in the Contracting State where they come from (Romania, nn) and according to the law of that State, if the person receiving their royalties is the beneficial owner, the tax so charged shall not exceed 10 percent of the amount of the royalties. The competent authorities shall agree on the modalities for the implementation of this paragraph." Confirmation comes from the wording of section 12, para. (1) of the Implementing rules of art. 118 of the Tax Code: "The provisions of paragraph 2 of Articles "Dividends","Interests","Fees","Royalties"of double taxation conventions concluded by Romania with other states that regulate taxation in the source country of those income, are applied with priority."

Under what conditions are applied the provisions of the convention for the avoidance of double taxation?

The answer is provided by art. 118 para. (2) of the Tax Code which states that "for the application of the convention for the avoidance of double taxation and EU legislation, non-resident is required to submit to the income payer,

at the time of income, the tax residence certificate issued by the competent authority from his state of residence, and, if necessary, an affidavit in which the indicating the fulfilment of the beneficiary conditions in case of enforcement of the legislation of the European Union [...]. "

Which is the accounting treatment?

In these circumstances, the Romanian entity R SA will perform the following records:

- Recording the royalty bill (issued on 01.11.2012)

612	401	4.564 lei
„Expenses with royalties, management and „Suppliers” rentals locations”		(1.000 euro * 4,564 lei/euro)

- Registration of VAT self-liquidation(4.564 lei * 24%):

4426	=	4427	1.095,36 lei
„Input VAT”		„Output VAT”	

- Registration of bill payment of November 25, 2012 (900 euro * BNR exchange rate 4,5313 lei / euro):

401	=	%	4.107,60 lei
„Suppliers”		5124	4.078,17 lei (900 euro * 4,5313 lei/euro)
		„Cash at bank in foreign currencies”	
		765	29,43 lei
		„Foreign exchange gains”	[900 euro * (4,564 – 4,5313) lei/euro]

- Registration of withholding income tax (100 euro * BNR exchange rate 4,5313 lei / euro):

401	=	%	456,40 lei
„Suppliers”		446	453,13 lei (100 euro * 4,5313 lei/euro)
		„Other taxes and similar liabilities”	
		768	3,27 lei
		„Other financial revenues”	[100 euro * (4,564 – 4,5313) lei/euro]

Profit and Loss Account for the month of November 2012 is affected with 4.5313 lei (operating expenses 4.564 lei minus financial income of 32,70 lei).

- Recording the payment of income tax (20/12/2012) based on the payment order and Form 100 for the month of November 2012:

446	=	5121	453 lei
„Other taxes and similar liabilities”		„Cash at bank in lei”	

Please note: Item 12 paragraph. (9) The rules for the application of art. 118 of the Tax Code states that "the provisions of Title V of the Tax Code apply when the beneficiary of the income obtained from Romania is a resident of a state with which Romania has concluded a double taxation convention or when the beneficiary of the income obtained from Romania, resident of a state with which Romania has concluded a double taxation convention, does not have a tax residence certificate or document referred to in section 13 para. (1) or when the tax payable by non-resident is borne by the payer of income".

Therefore, the use of the rate of CEDI is possible if and only if (i) is made the withholding of income tax of non-residents and (ii) the certificate of tax residence, respectively the declaration indicating the capacity of beneficiary is presented when paying the income to the non-resident. In other words, the tax rate to be used is 16% if payment when Romanian entity does not have a tax residence certificate of its provider in France. Obviously that the Romanian law allows the use of CEDI and regulate tax rate within the statutory period of limitation from the moment Romanian entity owns the certificate.

Note: Taxation with 10% of royalties based on art. 12 para. (2) of CEDI between Romania and France providing for taxation in the source state (Romania) does not lead to double taxation on the same income, because the state of residence (France) grants tax credit for tax paid in Romania, in accordance with Article 24 of Decree 240/1974.

Case 3: Taxation according to European legislation

European legislation aims to Council Directive 2003/49/EC of 3 June 2003 on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, as amended. This directive was implemented in the head. IV of Title V "Royalties and interest in associated companies" (art. 124 index 18 - art. 124 index 27) of Law no. 571/2003 regarding the Tax Code, to which I referred in the content section B3) of this material.

According to art. 118 para. (2) of the Tax Code, "the capacity of beneficiary in order to apply EU legislation will be proved by the certificate of tax residence and, if applicable, its affidavit of meeting the conditions relating to: the minimum holding period, condition of Minimum participation in the share capital of the Romanian legal entity, framing in one of the forms provided in Title II or Title V, as appropriate, the quality of taxpayer of income tax or a similar tax, without the possibility of an option or of being exempt."

What happens when the company F SA has the organization form SAS? In the EU legislation there is the proposal for inclusion in the category of enterprise of a Member State and businesses with SAS form of organization, regulation that Romania is not required to implement in the near future.

The following question arises: the Romanian state will accept the application of European legislation?, Given that:

- according to art. 118 of the Tax Code, the taxpayer can choose the most convenient regulation of the three (Romanian, CEDI and the EU);
- EU shall adopt the amendment of the Directive 2003/49/EC starting with 01/01/2013;
- Romania shall not implement the decision of amendment of the Directive 2003/49/EC (it is not obliged to implement it);
- art. 118 para. (2) conditions the application of the most favourable rate of European legislation only if the organization form of the French beneficiary is provided for under national law, in which organizational form is found SAS (simplified joint stock company)

among those listed in Article 124 index 26 of the Tax Code that a company can have to be known as "enterprise of a Member State".

Which is the applicable tax treatment? If we assume that there is a third company T SA that owns, in 2005 over 50% of shares (units) at each of the two companies R F SA and SAS. As art. 118 para. (2) conditions - wrongly, in our opinion - the application of European legislation (which requires, starting with 01/01/2013, the SAS organizational form) of the forms required by Title V of the Tax Code (which never took the shape of SAS), there is a risk that tax inspectors do not consider the conditions for the application of European law and tax by 16% the transactions of the entities R SA and F SAS. The forms provided by art. 118 and art. 120 of Law 571/2003 regarding the Tax Code and the establishment of the competencies in terms of signing these forms are approved by Order 724/2011. However, considering that in Annex 15 of the aforesaid order it stated that "the declaration of the beneficial owner - under Section A foreign legal entity (company F SAS, nn) says that with it has the following status / takes one of the forms listed in the list in Directive / Agreement", we consider that the Romanian payer may apply European legislation when French non-resident beneficiary F SAS submitted to the Romanian company before settlement of royalty bill: (i) the EU fiscal residence certificate (which proves that his tax domicile is the European Union), and (ii) the affidavit indicating the fulfilment of the condition of beneficiary in case of application of European Union legislation.

Reporting obligations

For each period during which the company R SA calculated and withheld income tax obtained by the non-resident, there is the obligation to report in form 100 "Statement on payment obligations to the state budget", in which case there must be a correlation between creditor turnover of the account 446 "Other taxes and similar payments" and the amount stated in that tax period.

Yearly, until 28/29 February this year for the previous year, the payer of revenue R SA must prepare and submit Informative statement on tax

withheld and paid for income subject to withholding / income exempted non-resident income beneficiaries. This is provided in the Annex, according to the form approved by section 15 index 1 of the Methodological Norms for the application of art. 119 para. (1) of the Tax Code. In this Declaration shall also be registered the income obtained by the non-resident in Romania and exempt from tax under the Tax Code or the avoidance of double taxation, as appropriate.

Conclusions

Revenues from royalties are exempt in Romania if the company F SA holds at least 25% of the capital of the company R SA for an uninterrupted period of two years.

Revenues from royalties are exempt from payment in Romania if the two companies expressly comply with the provisions of the Tax Code relating to (i) the quality of associated companies, (ii) the organization and (iii) tax status of tax payer.

In case the exemption or exemptions under national law conditions are not met, income from royalties are imposed:

- either according to CEDI, by withholding a share of 10% of gross income, if the company holds at the time of payment the certificate of fiscal residence of F SA in France;
- either according to the Tax Code of Romania, by (i) retaining a tax rate of 16% applied to gross income if holding tax residence certificate or (ii) applying a rate of 16% applied to gross income recalculated, in case the tax payable by French non-resident borne by the company R SA, whether "is attested the tax residence of the non-resident who derives income from Romania, [...] because from the CEDI benefits should benefit non-residents (especially in terms of lower tax odds of the conventions) and not Romanians payers who assume this tax that does not return to them "(Iordache et al, 2006, pg 152).

We believe that the spirit of the law as defined in Article 118 is to permit taxpayers, qualifying for resident and present documents proving the information expressly required, to benefit from the most favourable rate in

the domestic law, EU law or conventions for the avoidance of double taxation without conditioning this right to transpose EU legislation into national legislation.

To remove ambiguities and possibilities of different interpretations of this principle identified by letter. D) of this material on the forms of organization that are not taken into domestic law but are found in European legislation (as applicable SAS) we suggest:

- either updating operative articles of Romanian Tax Code which transpose the provisions of the EU legislation, meaning completing art. 124 index 26 letter. f) of the Tax Code, "among the companies covered by the provisions of art. 124 index 20 letter. a) (iii) there are [...] also other companies constituted under French law - for example, SAS - subject to French tax";
- either the inclusion in Title V of the Tax Code of a provision clarifying information on the character of Chapter IV of this Title, and the fact that the provisions of EU law is applied first.

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 - [9] Order 724/2011 for the approval of the forms provided for by art. 118 and 120 of Law no. 571/2003 regarding the Fiscal Code and establishing powers regarding signing this form;
 - [10] Council Directive 2003/49/EC of 3 June 2003 on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States;
 - [11] Decree 240 of 09/27/1974 ratifying the Convention between the Socialist Republic of Romania and the Government of the French Republic for the avoidance of double taxation on income and wealth.