

## Delimitations Regarding the Accounting and Fiscal Management of External Debts for Romanian Travel Operators

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### ABSTRACT

The specific activity of travel agencies consists in the sale and purchase of travel products. In case of travel operators In case of travel operators, including travel agencies, we find a couple of services provided by foreign suppliers, third persons and/or affiliates of the said entity, as for example: consulting, management, audit, services determined by the franchise regime. Therefore, a couple of invoices are received with explanations as "bonus", "franchise fee", "group license fees", "management fees", "group consulting", "logo creation for trademark rebranding" etc. Such transactions and operations require the thinking of the accounting treatment in terms of registration, assessment and acknowledgment (i) of the corresponding business debts, (ii) of determining the costs for the supply of such services, as well as the fiscal treatment. The two treatments can be designed and implemented starting from the contractual provisions, the nature and destination of services, the economic reality and, which is extremely important, the fiscal regulations.

All these generate economic, financial, accounting and fiscal risks, which requires a prudent and informed analysis of the provisions included in the service contracts.

### Introduction

As there are many situations when we face services received from third persons outside Romanian borders and we question ourselves how to settle things from the accounting and fiscal point of view, our aim is to make an inventory and then to analyze and substantiate an interesting casuistry. The objectives to be taken into account are distinct in terms of accounting than in terms of taxation, as follows:

**Table 1:** The objectives of accounting and of taxation

Accounting treatment	Fiscal treatment
acknowledgment and assessment of business debts;	declaration of service contracts at the Romanian fiscal authority, before starting their execution;
acknowledgment of services as costs;	analysis of the risks to consider that a non-resident person earns incomes by means of a permanent headquarters;

registration of service costs during the period when they were supplied (matching principle);	taxation of the profit or income derived by the non-resident person treatment applied from the VAT point of view.
conversion into lei, of the amount of the business debts expressed in foreign currency; update at the end of each month and at the end of the financial year of the business debts at the exchange rate valid for such dates;	
calculation and registration of Exchange rate differences on the debt settlement date.	

### Delimitations regarding the accounting treatment

As a general rule, taxation follows accounting. Therefore, we will first analyse the **accounting treatment applied to service contracts for the services received by travel operators** from external partners.

It should take into consideration the legal regulations, but also the accounting policy used by the company in terms of assets, debts, incomes and expenditure to be registered into the accounting of the Romanian beneficiary.

1. The accounting of undertakings practiced in Romania requires the registration of the cost of the services received from the external supplier in the expenditure account, during the period of supply, if there is a proof that they were actually executed, provided that a credible assessment is made and they are connected to the incomes of the same period of time.

Most services received from the companies in the tourism field are registered in the expenditure account (royalties, commissions, services for improvement of IT system, management fees, transport follow up fees, franchise, etc.).

However, there are cases in which the services can be registered in the cost of assets. For example, a Romanian travel company receives (i) services for implementation of a software to be used as intangible asset or (ii) consulting services for registration as international trademark with the State Office for Inventions and Trademarks, for all the classes found in the Nice Classification; in such case, the fee invoiced for the services supplied by external partners shall not be registered in the cost of the period, meaning in the profit and loss account, but it shall be registered in the cost of intangible assets because the requirements for registration of an asset are met, and not for the registration for a cost. On the date when the services are received, a fixed asset in progress of execution will be acknowledged, and after the software is commissioned or the trademark registration certificate is issued by the State Office for Inventions and Trademarks, the intangible asset will be registered.

2. What date do we register the debts towards the external supplier? It shall be registered on the date when the acknowledgment requirements are met: (i) the obligation must be present, (ii) to result from past transactions, (iii) to be credibly assessable and (iv) in order to extinguish it resource outgoings are required (usually effective money) incorporating future economic benefits.
3. To what amount will be the debt initially registered? The initial assessment concerns two issues: (i) it shall be made at the nominal value of the external debt, in the currency agreed in the contract concluded between the parties and (ii) the conversion in lei of the foreign currency will be made at the exchange rate of the National Bank of Romania valid on the transaction date.
4. How will the debt be subsequently assessed? If the debt is not extinguished, by payment, until the end of the month in which it was registered, then it will be updated at the exchange rate of the National Bank of Romania from the last bank day of such month. In this case, costs or incomes resulting from exchange rate difference will be calculated and registered, as the case may be. The same treatment will also apply at the end of each month taking into account the outstanding amount and the assessment made at the end of the previous month.

5. How do we assess the debt on the payment date? The extinction of the debt will always be made at the reference exchange date of the National Bank of Romania from the date of the last assessment.
6. How do we assess the effective money in foreign currency on the payment day of the debt? The assessment shall be made only at the National Bank of Romania of the payment date. Again, costs or incomes resulting from exchange rate difference will be calculated and registered, as the case may be.
7. Which is the size of the debt to be paid? At the debt payment date, total or partial, the accounting treatment will take into account the obligation to withhold the income tax for non-residents or its settlement in the country of residence of the external supplier. If the income tax for non-residents is not owed in Romania, the debt will be paid. If income tax for non-residents is owed and it should be withheld, at the payment date of the external debt the tax shall be established in foreign currency, by application of the legal rate (indicated in the Convention for avoiding double taxation or in the Fiscal code, according to the actual situation) to the amount to be paid. The foreign currency will be converted into lei at the exchange rate of the National Bank of Romania from the payment date of the external debt. As the withholding is made from the outstanding debt, it results that (i) it will be decreased with the amount in foreign currency of the withheld tax. The income tax, expressed in lei, will be registered as a debt towards the Romanian state.

**Remark:** If there is the obligation to withhold the income tax for non-residents, but the debt was fully paid to the external supplier, the economic operator is the one who will pay the tax on the account of operational expenses, but which from the fiscal point of view will be non-deductible. The debt paid to the supplier shall be considered to be a net amount, which will be therefore completed in order to apply the taxation rate to the obtained gross.

### **Delimitations regarding the fiscal treatment**

In interdependence with the accounting treatment analysed above, we should focus now on the fiscal treatment in terms of (i) deductibility of costs for received services; (ii) use of transfer prices in case of affiliates; (iii) taxation of the incomes earned by the non-resident; (iv) VAT regime.

1. In terms of the profit tax, we should consider the fact that art. 21 paragraphs (4), letter m) of the Fiscal code considers non-deductible the costs for management, consulting, support services or other services for which the Romanian beneficiary cannot justify their necessity for the purpose of the carried out activities and for which contracts are not concluded. For the implementation of this article point 48 is issued of the Methodological norms of implementation of the Fiscal code, which says that in order to deduct the costs for management, consulting, support services or other services the following requirements should be cumulatively met: (i) the services must be effectively supplied, to be executed based on a contract concluded between the parties or based on any contractual form established by the law; justification of the effective supply of the services is made by: work statements, acceptance minutes, work reports, feasibility studies, market studies or any other corresponding materials and (ii) the Romanian taxpayer must prove the necessity of the costs based on the specific nature of the carried out activities.
2. In terms of the transfer prices, art.11 paragraph (2) of the Fiscal code regulates that within a transaction between affiliates, the fiscal authorities can adjust the amount of the income or cost of any person, as it might be necessary, in order to reflect the market price of the good or services supplied within the transaction. In terms of affiliates, the answer to at least two questions will be searched for: (i) is the service actually supplied? And (ii) would the service beneficiary have used the services if it was a person independent from the parent company?

The applied methods are: (i) the resale price method, (ii) the price comparison method and (iii) the cost-plus method. Additionally, any other method can be used which is acknowledged

in the guidelines on transfer prices issued by OECD (Organisation for Economic Co-operation and Development).

The establishment of the market Price of the goods and services settled between affiliates starts from the behaviour which two independent persons would have had if they were in the position to conclude such transaction, taking into consideration the correct and legal establishment of the price or fee. This is why, in case of services, the usual or standard fees in the said branch are compared. If there is no information available, the cost-plus method shall be used.

Please be reminded that there is the possibility, in case of transactions concluded with non-resident affiliates, to submit with the Romanian fiscal authority an Advance payment agreement for each supplier of goods and/or services, which is a non-resident affiliate. If such an agreement exists, the authorities shall establish the market price of the goods and services determined by the method used and declared by the parties. If such an advance payment agreement does not exist, the fiscal inspection can be suspended until the file of transfer prices is made available. The refusal to submit the file of transfer prices or its incomplete submission at the established term shall entitle such authorities to estimate the amount of the transfer prices.

**Remark:** It should be checked up if the Romanian legal person has the obligation to declare the contracts concluded for services of the nature of construction works, assembly, supervision, consulting, technical support and any other activity, executed by foreign legal persons or natural persons who are not resident on the Romanian territory.

3. Fiscal treatment of the taxation of incomes earned by non-residents in Romania, is aimed at establishing the state in which the income earned by non-resident persons should be taxed: in Romania or abroad, respectively the taxation rates (the ones stipulated in the Convention or in the Fiscal code).

First of all, the Fiscal code should be checked up in order to determine whether the incomes earned by the non-resident from domestic travel operators are taxable in Romania or not. The taxable basis is usually represented by the taxable gross income earned in Romania and the taxation rate is 16%. The domestic laws provided that this tax should be calculated by withholding upon income payment, and it will be paid to the state budget until the 25th day of the month following the one in which the income was paid. Please note that there are situations when the Fiscal code also provides that certain incomes are exempted or not taxable, especially when the external partners hold for a minimum period of time interests with the Romanian companies.

However, an analysis should be made in terms of whether there is a Convention for avoiding double taxation concluded between Romania and the state of the external supplier, and based on such convention to establish the nature of the income, the rate and place where such income is to be taxed. If the income is not taxable in Romania or the taxation rate in the Convention is smaller (more convenient) than the rate established in the domestic laws, please take care that in order to apply the dispositions of the Convention for avoiding double taxation, it is compulsory that the Romanian travel operator withhold the tax at the most convenient rate, if applicable, and to be in the possession of the Tax residence certificate of the non-resident issued by the fiscal authorities of the supplier's state of residence.

If the tax is owed in Romania, the travel operator will have to fill in and submit (i) periodically, Form 100 "Return regarding payment obligations towards the state budget", for each month in which such tax is owed, respectively (i) on an yearly basis, "Informative return regarding the tax withheld and paid for the incomes with withholding regime/exempted incomes, for non-resident income beneficiaries", until the 28th/29th of February of the current fiscal year for the expired year.

4. In terms of the VAT fiscal treatment, we have to analyse the nature of services and the quality of the persons involved (the two partners are or are not taxable persons registered for VAT purposes). Also, from the VAT point of view the following should be

established: (i) the place (territoriality), (ii) the date when the generating fact takes place and the tax enforceability, (iii) the applicable rate, (iv) the person who has the obligation to pay the tax, (v) the payment modality of the tax (usually by reverse taxation), (vi) the report modality by tax returns (by Forms 300 and 390 VIES), (vii) the requirements which the travel operator has to meet in order to be entitled to VAT deduction TVA etc.

## Conclusions

Our analysis proves:

- the importance of negotiating the business contracts and also other types of contracts taking into account all the legal, economic, financial and fiscal issues of a transaction;
- the importance of a good and efficient communication between the responsible specialist managers;
- the necessity to conceive the accounting and fiscal treatment corresponding to the business debts on the negotiation date of the contract, which is before the conclusion of transactions and not as they are carried out;
- the necessity to identify, quantify and organize fiscal, financial and accounting risk management at the three basic levels: VAT, profit tax, income tax for incomes earned by non-residents in Romania.

More than this, we recommend all executive officers (from operational managers to higher managers) to actively participate in all phases (from the ones related to the drawing up of the contract to the ones effectively related to its execution). It is necessary to have a procedure including clear instructions regarding operative records specific to the transactions resulting from the contract, circuit of documents, control, of activities and persons in charge, form and term of communication towards the authorized persons of the information written in various supporting documents and non-standard reports with the standard ones etc.

We also recommend during the carrying out of the transactions, to follow up the following: (i) any change in the national or international business, accounting and fiscal laws which might have an impact on the transaction in progress; (ii) any contract change regarding the nature of the supplied services or their actual execution; and (iii) the incidence of the above-mentioned changes on the accounting, financial and fiscal treatment.

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