

Fiscal risks implied by cross-border activities

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The Covid pandemic has led to a strong development of the electronic communication and thus to extended possibilities to carry out activities remotely. Since certain countries offer comparatively advantageous tax rates, more and more managers and entrepreneurs are considering to establishing a company abroad, respectively enabling the remote management of companies.

Such circumstances often imply fiscal challenges – especially in case of remote cross-border activities. Two important risks are:

Permanent Establishments (“PE“)

In case a non-resident person meets the conditions for the existence of a PE in Romania, it must register this PE with the Romanian Financial Administration and subject the income of such PE to the Romanian corporate income tax. Romanian records have to be kept for the PE.

Likewise, permanent establishments of Romanian companies located in another states must be fiscally registered and have to fulfill certain accounting and fiscal obligations.

The regulations on establishing the fiscal PE are very similar in most countries. According to the main regulation, a PE means a place (also a subsidiary, an office, a construction site, a construction project, a construction execution or an installation with a certain duration etc.), from which the activity of a non-resident person is carried out in full or in part (i) directly or (ii) through a subordinate representative.

A permanent establishment can be established, for instance, if one or several employees are active in a fixed place located in another state. A home-office, a server, a building or an installation firmly anchored in the ground can also represent, under certain circumstances, a “fixed place” within the meaning of the abovementioned regulation. Moreover, also situations in which a person having the right to sign, to negotiate or to take decisions, such as a sales agent, an executive employee or a managing director, carries out its activity remotely in another state, should be carefully assessed.

Fiscal residence

The fiscal residence affects both natural and legal persons.

In order to determine the fiscal residence of a legal person, one should take into account the headquarters of the commercial activity and the place of the actual management.

In the case of a natural person, there are other criteria to be taken into account, such as domicile, center of vital interests, residence and, as the case may be, the stay duration of the respective person in Romania. Persons which, according to the legislation of a state, are considered residents from a fiscal point of view, are subject to an unlimited tax liability in that particular state, i.e. they must pay tax in that state for their income earned worldwide.

Problems may occur when the income of a person is considered to be taxable in two states or when this person is considered to be a resident from a fiscal point of view in two states. In such cases the risk of double taxation arises.

More and more often, such questions arise with regard to Romanian companies having their headquarters in Romania, when the managing directors strategically decide upon the commercial activity of the Romanian entity from abroad.

Such a configuration may entail the risk that the fiscal administration of the other state considers a company as resident (also) in this other state, based on the place of management. This may lead, as the case may be, to the tax assessment of the company in this other state, as if it were a local company, triggering significant financial and personal consequences.

Likewise, the Romanian Fiscal Administration can consider companies whose managing directors live in Romania and perform from here activities for their companies in other states as liable for taxation.

It is worth to mention that the fiscal residence of natural and legal persons can be established officially by the Fiscal Administration based on certain formalities. A confirmation is useful for clarifying the taxation right related to the income of a person.

Practical relevance

The growing digitalization and attractive tax rates in other countries encourage entrepreneurs to establish companies in states with lower tax rates, in order to manage these remotely. Natural persons could also seek tax advantages by transferring their fiscal residence or income to states with lower tax rates.

In such situations, one should nevertheless be careful, in order to avoid fiscal complications. So-called “artificial arrangements” which hide the true substance of the enterprise for the purpose of gaining fiscal advantages will be aggressively tracked and sanctioned by fiscal administrations.

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