

Business restructuring options in Romania: Spin offs

by Costina Constantin, Fellow Chartered Certified Accountant (FCCA)

Certified Internal Auditor (CIA)

Financial auditor

As the business environment is constantly changing at a high pace, the investors must be able to make the best-informed decision when it comes to investment or disinvestment decisions. Each business restructuring option available to investors in Romanian companies has specifics regarding the background, implementation process, tax treatment of the investment or disinvestment and associated costs.

Depending on the intention of the investors, whether or not to combine two or more businesses together or to spin-off an existing business, below is a short overview of the requirements and specifics of the key business restructuring transaction types, with an emphasis on the spin-off.

Key features of restructuring operations

A merger operation is the option to follow in those cases when the investors are interested in combining the activities and the net assets of two companies, and it results in one company absorbing another company(ies), with the latter(s) being subsequently dissolved.

A spin-off is the opposite of a merger, when the net assets of an existing company is transferred, totally or partially, to a newly created company or to an existing one.

The companies can go through a voluntary liquidation, decided by its shareholders, or a company can be liquidated as a result of bankruptcy. The prerequisite of a voluntary liquidation a company is that the company to be able to pay all its debts from existing cash and all liabilities are paid before the shareholders' liquidation decision is published.

The downside of the restructuring operations – mergers, spin-offs, liquidations – is their **length and complexity, implying a two-step legal procedure** which can take from six months to one year, and involve formalities to be carried out with the Romanian Trade Registry, but the key advantage of the mergers and spin-offs is that **no price needs to be paid for the net assets transferred**, while the shareholders of the absorbed company (in case of mergers) of the dividing company (in case of spin offs) receive shares within the in exchange of the net assets absorbed/transferred. Also, if certain prerequisites are observed, the transfer of the net assets within mergers and spin-offs is **not taxable for corporate income tax or VAT purposes**.

Key features of spin-offs

- **Tax treatment of spin-offs:**

- **Corporate Income Tax**

The Romanian Fiscal Code ("RFC") sets out the tax treatment of spin-off operations in order to reach corporate tax income neutrality. The fiscal provisions define **total spin-offs** as the reorganization operation when one company fully transfers its assets and liabilities towards two or more existing or newly created companies, in exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities. As a result of a total spin off, the transferring company shall cease to exist.

The **partial spin-offs** are defined from fiscal point of view as the operations where a company transfers one or many branches of activities towards two or more existing or newly created companies, retaining at least one branch activity, in exchange for the pro- rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities.

In the case of partial spin-offs care must be paid when defining the activity branch(es) to be transferred, as to meet the criteria stated in the RFC, of all the assets and liabilities of a division of a company which from an organisational point of view constitute an independent business, capable of functioning by its own means.

The company undergoing a spin-off must transmit to the receiving companies a list containing the tax value of the assets and liabilities thus transferred, as well as of the reserves which make part of the shareholders' equity, indicating the tax treatment applied upon setting up.

- **VAT**

The transfer of the net assets is not a taxable transaction for VAT purposes for the beneficiary companies, provided that the successors are VAT registered tax persons.

- **Process documentation and approval**

The **spin-off plan** is signed by the legal representatives of the company. The plan has to contain a **solid motivation on the financial and commercial background** and identify the benefits of the spin-off, as well as the proving the



existence of a branch of activity capable to independently function and carry out its operations, as the judge will check such motivation.

Conclusion

In conclusion, the existing business combination options are quite complex operations, implying a long and formal process, and carrying out the risk of not fulfilling the criteria that makes such operations tax neutral.

Contact and further information:



STALFORT Legal. Tax. Audit.

Bucharest – Bistrița – Sibiu

Office Bucharest:

T.: +40 – 21 – 301 03 53

F: +40 – 21 – 315 78 36

M: bukarest@stalfort.ro

www.stalfort.ro