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THE INFLUENCE OF ACCOUNTANCY DATA ON THE TRANSFER PRICING POLICY IN ROMANIA

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Abstract: *When adopting the transfer pricing policy, tax affects not only the company, but also the main indicators of performance, cash flow and business strategy. Through the transfer pricing policy, which is actually a commercial policy of the company in relation to related parties, methods for determining prices in the future are established, related party transactions, complying with the principle of market value. This article also presents practical elements on the harmonization and fiscal accounting principles in the field of related party transactions, so as to ensure a better management of tax risk. Also, it seeks clarification of conceptual and practical aspects of transfer pricing, welcome for financial accounting professional knowing that the tax authorities have rised the number of controls in this area.*

Key words: *jointy, pricing transfer, the principle of market value, the file containing the transfer pricing, the principle of market value, the file containing transfer pricing*

1. Introduction

In the economic legislation, as well as in the fiscal one from Romania, the principle of market value was introduced beginning with the year 1994 and it is going to be applied to all transactions between jointies, namely transactions between companies joint in the same group, including the ones going onward between a foreign business company and its permanent headquarters in Romania.

The concept of transfer pricing, principles and market pricing methods, as well as the guidance for taxpayers and tax administrations come from the Organization from Economic Co-operation and Development (OECD).

In the international legislation, the following are considered to be relevant in what concerns transfer pricing:

- Framework Convention for the Avoidance of Double Taxation
- Code of Conduct on transfer pricing

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- OECD Guidelines - transfer pricing guidelines for multinational enterprises and tax administrations (2017).

The transfer pricing legislation in Romania complies with the lines of the OECD transfer pricing guidelines for multinational enterprises and tax administrations and with the guidelines established by the European Union Forum on transfer pricing, being represented by the Tax Code (Law no. 227/2015), Civil Code (Law no. 287/2009), the Tax Procedure Code (Law no. 207/2015), OPANAF no. 222/2008 regarding the contents of the transfer pricing file, OPANAF no. 442/2016 on the amount of transactions, time for preparation, content and conditions for applying for file transfer pricing and procedure for adjustment / estimation of transfer pricing, OPANAF no. 3049/2017 regarding the approval of the form - Report for each country.

Section 3 deals with the coming into force in 2016 of the law that requires the compulsory drawing up of the transfer pricing file and therefore. Following this law, companies have started to treat and analyse transfer pricing and documenting transactions more carefully, given that tax authorities in Romania have strengthened controls in this area; the last operation is known as "operation Iceberg".

The pricing policy transfer can be defined as "a formal document signed by the management bodies of a company that regulates the main way to calculate transfer prices within each category of transactions with related parties" (Barbosanu, SBORA, 2018). If the transfer pricing file arguments the fact that joint party transactions concluded in the past comply with the principle of market value, as agreed, the transfer pricing policy is used for the pricing of future transactions with related parties.

Accounting information, the result of accounting the policies adopted by the company, represents the bottom line for the analysis of the circumstances in which the transactions with affiliated parties have occurred and the starting point for developing the transfer pricing policy. Subsequently, the transfer pricing policy is developed taking into account the accounting information and the business strategy of the company. The transfer pricing policy is updated whenever new transactions occur or in order to maximize results of the entity.

Section 4 of the paper presents the tools for the harmonization of accounting and taxation, which the transfer prices policy must include and which are used by companies to better manage the tax risk, namely: anticipated individualized tax solution, handling fiscal result through transfer pricing and advance pricing agreement.

In section 5 of the paper, the conclusions of the research are presented, with emphasis on the idea according to which it is necessary to disconnect taxation from accounting. Reference is also made to the fact that the existence of legal requirements regarding the documentation and reporting of transactions with affiliated parties discourages multinational companies to move their profits through the transfer pricing mechanism in countries with more relaxed taxation. Another conclusion of this research is related to the approach of transfer prices as a business reason and not as a tax problem.

2. Accounting and Tax regulations related to affiliated Parties

From an accounting point of view, the International Financial Reporting Standards

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(IFRS) and the Romanian accounting regulations (OMFP 1802) are harmonized with respect to the notions specific to the affiliated parties, i.e.: affiliated entities, associated entities, jointly controlled entities, related parties. The definitions in the Tax Code for these notions are for tax purposes and do not exactly overlap with the accounting ones.

The relationship between two entities, according to IFRS, implies the possession of capital rights and the power to significantly control the other entity. Depending on the two criteria, namely the percentage of capital held and the power to control, a company may have subsidiaries, associates or jointly controlled entities. The Order of the Ministry of Public Finance no. 1802/2014 regarding the individual annual financial statements and the consolidated annual financial statements (OMFP 1802) establishes a threshold of 20% for the participation interests.

OMFP 1802 defines the **subsidiary** as "an entity controlled by a parent company, including any subsidiary of the parent company that runs them". IFRS 10 – Consolidated financial statements defines the **subsidiary** as a company controlled by another company and provides details on the term of **control**, which is analysed in correlation with the power over the holding company, and depending on the power and obtaining rewards as a result of the capital held.

According to the Romanian accounting rules (OMFP 1802,) the **associated entity** involves cumulative compliance with two conditions: the existence of a participation interest and the ability to significantly influence the policies of the associated company. The exercise of a significant influence implies the possession of at least 20% of the voting rights. The definition of the **associated entity** is given by IAS 28 - Investments in associated entities and joint ventures (IAS 28) as the company in which the investor has a significant influence, which implies, first of all, the possession of at least 20% of the voting rights of the entity in which it has invested. In addition, there is also significant influence when the investor has a representative on the board of directors or has the power to influence the policy of the associated company, including the one regarding the distribution of dividends, or if s/he carries out important transactions with that company, as well as when conducting the inter-change of management personnel or providing important information to the company.

Jointly controlled entities are mentioned in OMFP 1802 at point 4.4.5. Financial assets, without defining them. Further details regarding the ***joint control*** are mentioned in section 8.10 – Exercise of the joint control, where it is mentioned that it intervenes provided all those who control the company agree on the important activities of the company. IFRS 11 – Joint Agreements defines ***joint commitments*** as either a joint exploitation or a joint venture, and it has the following characteristics: the contractual commitment is binding on the parties and through the contractual commitment, two or more parties are granted joint control of the commitment.

The Romanian accounting regulations draw on the definition offered by IFRS regarding the ***related parties***, being defined in the definitions section. A detail is made at art. 474 and 475 of OMFP 1802. IAS 24 – Presentation of the information regarding the affiliated parties, specifying the conditions that must be fulfilled in order to be ***related parties***, namely:

- in the situation of direct or indirect control, of the joint control over the entity;

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- according to IAS 28 - Investments in associated entities, it is an associated entity of the company;
- according to IAS 31 - Interests in joint ventures, it is a jointly controlled entity;
- the affiliated party is a key staff member of the management of the parent company or firm or is a close family member of a natural person;
- the party is an entity that is controlled, jointly controlled or over which a significant influence is exercised, or the voting power in this entity belongs directly or indirectly to a natural person;
- it represents a post-employment benefit plan for the employees of the company.

In terms of tax, the ***concept of affiliation*** is defined in Law no. 227/2015 on the Tax Code and implies that a legal person has at least 25% of the voting rights to the other legal person or s/he has control over it.

The tax code defines the affiliation also in the case of natural persons if they are spouse or relatives up to the third degree including. The affiliation between a natural person and a legal person occurs when the natural person holds at least 25% of the voting rights of the legal person or if s/he has control over it. The effective control over a legal person intervenes if the legality and reality of the fact establish that, by using information, documents, the administrator or the management of the company has the power of decision on the activity of the legal person concerned, by concluding transactions with other legal persons that are under the control of the same administrator/ management personnel or as the management person within the legal person is a shareholder or administrator within the legal entity concerned.

The table below presents the obligation to prepare the transfer pricing file, according to the legal provisions in force (O.P.A.N.A.F. no. 442/2016, the values exclude VAT, the exchange rate communicated by the NBR valid for the last day of the tax year):

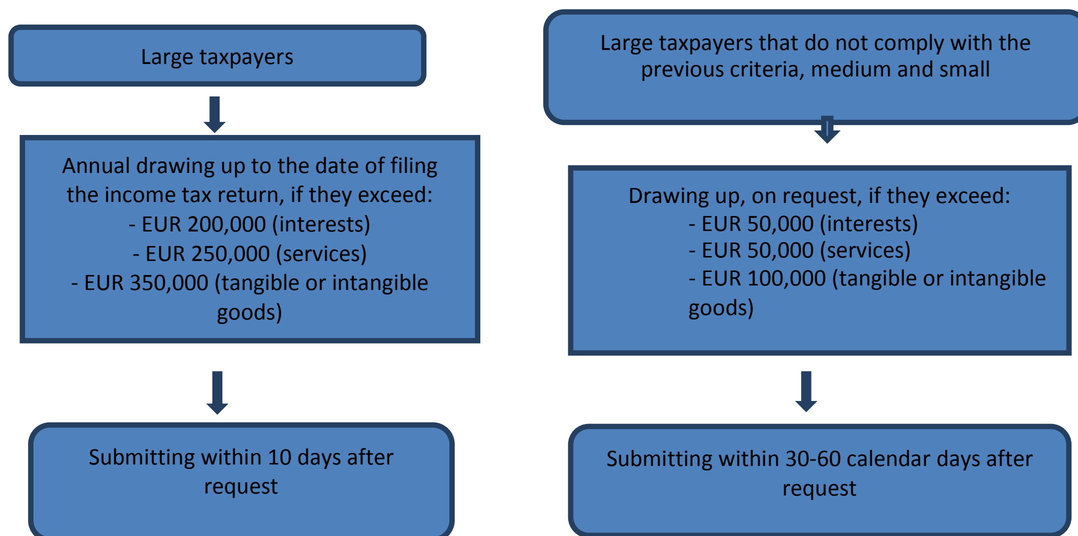

Fig. 1. *Obligation of drawing up the transfer pricing file*

Source: author

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3. Financial and Tax Reporting of Transactions with related parties

As one may see from the graph below, the group's policy on transfer pricing is locally applied after applying the adjustments required by the Romanian legislation in this field or when the entities do not have a transfer pricing policy:

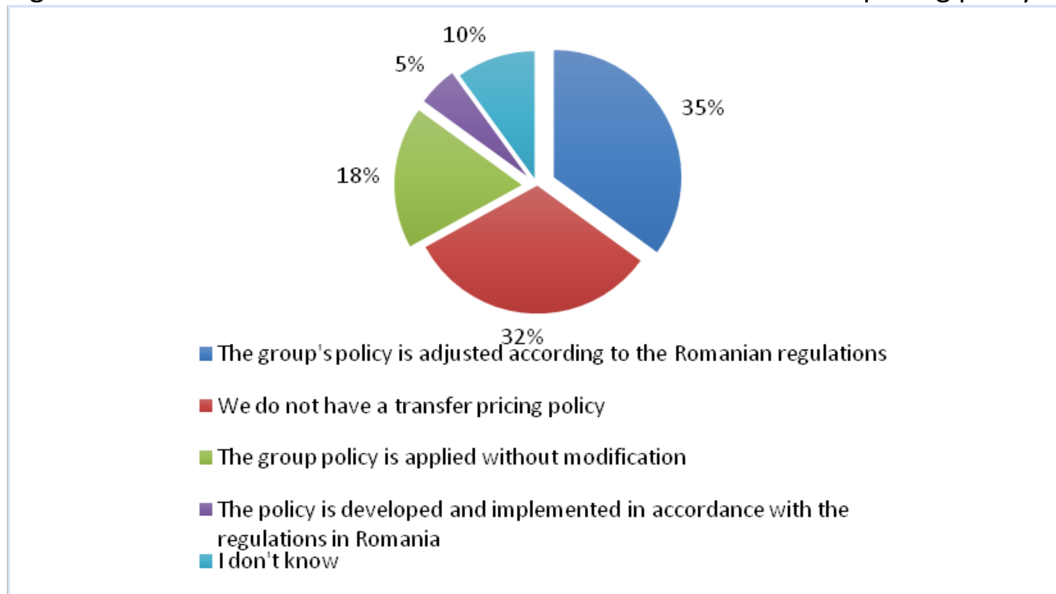

Fig. 2. *The determining factors of drafting the transfer pricing file*
Source: the authors' own processing based on the data provided by the study conducted by PKF Finconta on *Transfer Pricing in Romania*, 2018

Transfer prices affect not only the companies, but also the main performance indicators, cash flow and business strategy. These are the reasons why companies belonging to a group have to argue (in the transfer pricing file) that the prices practiced in intra-group transactions comply with the principle of market value, in order to avoid possible adjustments proposed by the control authorities.

If a company has conducted transactions with an affiliated party, then, in the notes to the financial statements, it shall present additional information regarding the nature of the relationships, as well as details about the transactions and balances with that affiliated party. The purpose of the information provided is to understand the way in which these transactions influence the financial statements of the reporting company.

The international accounting standard governing the way of reporting transactions with affiliated parties is IAS 24 – Submitting information on affiliated parties. The standard was gradually introduced in the Romanian legislation. In accounting, it was introduced by the MFP Order no. 2.844 of 2016, referring to the obligation of reporting according to IFRS by the companies whose transferable securities are traded on a regulated market, as well as by the MFP Order no. 1802 on the individual annual financial statements and the consolidated annual financial statements.

In Romania, the exchange of information between the tax authorities became

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operational through the coming into force of GEO no. 42/2017 and OPANAF 3049/2017. The *reports for each country* introduced by this order allow tax authorities to have a comparative picture of the fiscal and economic involvement of a multinational group in each area in which they operate. Tax authorities use the information for the analysis of transfer prices and for the purpose of carrying out tax inspections of companies affiliated to multinational groups.

Transparency and the exchange of information between different countries has greatly increased in recent times. Starting with 2016, it is compulsory for multinational companies with a turnover of more than EUR 750 million to have the “Country-by-country reporting”, whose deadline for submitting was 31.12.2017. The report is submitted in the countries where parent companies are established and includes information on the turnover obtained by the company in each country in which it operates, taxable profit, tax of profit paid, number of employees and tangible fixed assets, other than cash or cash equivalent.

4. Analysis of the Harmonization of Accounting with Taxation from the Perspective of Transfer Prices

Within a company, three important functions are affected by transactions with related parties, namely: accounting, taxes and treasury.

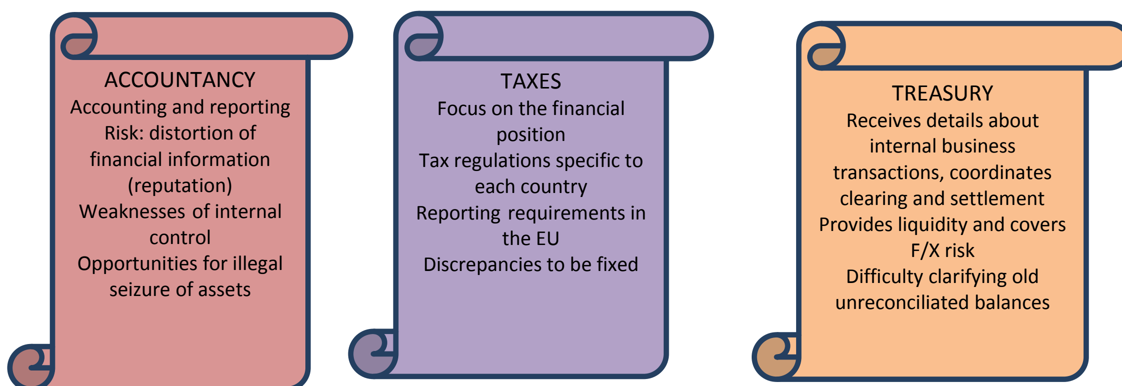

Fig. 3. *Functions of the company affected by the transactions with related parties*

Source: The authors’ own processing of information provided by Anghelache Marian during Focus Audit SRL regarding Transactions between affiliated companies, a risk divided between entity, auditor and investor, 2017

Between accounting and taxation there must be a neutral relationship, which should not be affected by tax, in order to make the accounting information useful to those interested. The tax information can be highlighted off-balance sheet and presented in the notes to the financial statements.

The main tools for reconciling accounting with taxation, used for better managing tax risk by companies are: the anticipated individual tax solution, the manipulation of the tax result through transfer prices and the advance price agreement.

The anticipated individual tax solution (SFIA) is defined by Law no. 207/2015 on the

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Tax Procedue Code, as an administrative document issued by the central tax body to solve a company request and which regulates future tax situations. SFIA intervenes when the company shows difficulty in interpreting the tax legislation and represents a definite answer from the tax authorities.

The manipulation of the transfer prices has increased as the transactions with affiliated parties increase; it is a tool for reconciling the interests of multinational companies, for carrying out transactions at fair prices, and, for tax administrations, for collecting taxes in their jurisdiction, to the highest values. It is carried out by means of transactions with tangible, intangible assets or services, between affiliated persons, realized at values lower or higher than their market value, in order to obtain economic benefits or to circumvent from complying with the tax obligations. It is about setting prices different from their market value, regarding the transmission between affiliated persons, of the ownership right over some goods, in order to realize some economic or tax interests.

In order to ensure the compliance with the market value principle in transactions with affiliated parties, companies that carry out large-value and continuous transactions, involved in several countries, with different legislative approaches in the field of transfer pricing, may use the *advance pricing arrangement (APA).* The advance pricing arrangement is "the administrative document issued by the central tax authority in order to solve a request of the taxpayer/payer, regarding the establishment of the conditions and the modalities in which, during a fixed period, transfer prices will be determined, in the case of transactions performed with affiliated persons, as defined in the Tax Code" (Law no. 207/2015 on the Tax Procedure Code).

The accounting of transactions with related parties leads to an increase of the tax risk of the entity, due to the divergences between the accounting principles and those of the taxation. Analysing from the perspective of the Romanian legislation, we identify three major sources of divergence between the accounting and the tax interest (Cuzdriorean, 2011, 2014), namely:

- *Taxation of the profit* obtained by Romanian legal persons from the activity carried out through the permanent headquarters located in a foreign state, or obtained from Romania, by non-resident legal persons from Romania, through the permanent headquarters or the taxation of certain categories of income obtained by them in Romania. The taxation of the profit implies the compliance with the provisions of the tax legislation in Romania or with the conventions for avoiding double taxation, depending on the compliance with certain conditions required by law.

IAS 12 - Corporate tax establishes the way in which the current and deferred income tax is accounted for, as well as the recognition of receivables or debts with deferred tax.

Deferred taxes are determined on the basis of temporary differences, which represent the difference between the book value of an asset or liability and their tax base. The deferred tax liability represents the corporate tax to be paid in future periods as a result of the existence of taxable temporary differences. The deferred tax asset represents the corporate tax to be recovered in future periods as a result of the existence of temporary deductible differences, deferred losses or unused tax credits.

In the notes related to the financial statements, the companies show the relationship between the corporate tax expense and the accounting result as harmonization

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between the expense with the corporate tax and the accounting result multiplied by the tax rate, or as harmonization between the average tax rate and the applied tax rate. In the event that there are no permanent differences, we will have a corporate tax expense resulting from multiplying the tax rate with the accounting result prior to taxation.

If there are temporary differences, we will have a higher cost than this product (in the case of the existence of taxable items) or lower (in the case of the existence of deductions).

➢ *The depreciation of the fixed assets* is closely related to the calculation of the corporate tax. The tax rules are the ones that establish the deductible expenses when calculating the corporate tax. Any change in depreciation affects the income tax in the opposite direction.

The entities use both accounting and tax depreciation. The company's accounting and fiscal policy regarding the depreciation of the fixed assets has economic and tax implications, they establishing the policy of valuing the fixed assets, the adopted depreciation regime, and the degree of depreciation deductibility when calculating the corporate tax.

The depreciation involves the accounting and tax recovery, during the entire duration of use of an asset, of the costs that the company has registered with its acquisition, production, or improvement.

Accounting depreciation involves establishing the useful life, the period of time during which the asset can be used for use, respectively, through the company's accounting policies.

The tax depreciation is determined starting with the month following the one in which the asset was put into service, taking into account the useful life established on the basis of the Catalogue regarding the classification and the normal operating times of the fixed assets, approved by the Government Decision no. 2139/2004. By tax depreciation, the value of the asset is distributed on expenses, according to the normal life of the life stated in the Catalogue.

The International Accounting Regulations (IFRS) through IAS 12 Corporate tax regulate the way of addressing the differences that arise as a result of applying accounting methods different to tax ones. The Romanian accounting regulations (OMFP 1802) do not deal with this aspect, the General Accounts Plan approved by this order not including accounts for the reflection of the deferred taxes. The entities applying the Romanian accounting regulations calculate and show in accounting only the accounting depreciation, while the tax depreciation is calculated and emphasised by the extra-accounting. We consider that the tax should be disconnected from the accounting, in order for the deferred taxes to be included in the MFP Order no. 1802/2014.

Companies applying IFRS shall apply IAS 12 - Corporate tax in order to calculate and highlight the differences between *accounting depreciation and tax depreciation*. MFP Order no. 2844/2016 for approving the Accounting Regulations in accordance with IFRS (OMFP 2844) regulates accounts for deferred taxes in the General Accounts Plan.

➢ *Assessing patrimony*

Companies prepare financial statements to be submitted to internal or external users.

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Financial statements may seem similar from one country to another. However, there are differences that can be caused by a variety of factors: social, economic and legal, as well as the needs of financial statements users in certain countries, when establishing national requirements. These factors have led to the use of various definitions of the structures of financial statements, such as: assets, liabilities, equity, income and expenses and have contributed to the use of different criteria for recognizing the structures in the financial statements and the option for different valuation bases. The information presented in the financial statements were also influenced (OMFP 2844).

Determining the fair value according to national or international accounting regulations is a complex process, which involves assessing and accounting knowledge.

The assessment is required whenever the companies transfer business or parts of business, assets or services, between them and aim at demonstrating that the price at which the transfer was made is a market price. For this purpose, an assessment report is prepared, which is the basis for drawing up the transfer pricing file required by the tax legislation.

The differences existing between the balance sheet and the tax one, between the accounting profit and the tax account (corporate tax statement) highlights the idea of disconnecting accountancy from taxation, with the purpose of obtaining a fair view on the financial statements.

5. Conclusions

It is necessary to disconnect tax from accounting, in order for the issue of deferred taxes to be regulated in the MFP Order no. 1802/2014, following that the entities applying the Romanian accounting regulations calculate and highlight both the accounting depreciation and the tax depreciation in accounting.

The legal requirements regarding the documentation of the transactions with the affiliated parties, as well as those connected to reporting these transactions discourage multinational companies to move their profits through the transfer pricing mechanism in countries with a more relaxed tax system.

Transfer prices influence both the corporate income tax due and the company's performance indicators, the treasury and the business strategy. Although companies' management and financial management are aware of the importance of the transfer pricing, the transfer pricing policy is rarely taken into consideration when drawing up strategic decisions. The existence of an efficient policy in the field of transfer pricing contributes to a good management of global operations, representing a tool for increasing profit, which may be achieved by increasing the turnover, reducing costs, taxes and fees, in compliance with the legal provisions. Including the transfer pricing policy in the company's strategic planning could turn it from a tax problem into a business reason.

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IAS 24 – Submitting Information on Related Parties

IAS 28 - Investments in Associates Entities and Joint Ventures

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