RESEARCH ARTICLE:

The taxation regime of the project company involved in a concession or a PPP project

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ABSTRACT

The legal conditions for the development of a public project are subject to intensive debate as involves public funds. Romanian legislation provides for several types of contracts but not all of them are used in practice due to lack of understanding of these conditions. Since 2010 when the PPP Law entered into force no project was launched despite several public authorities expressed their interest in using this type of contract and Government established a public body to deal with PPP projects. Several authors commented the laws in force and proposed different approaches in order to ensure the applicability of the PPP Law.

The tax analysis is also necessary when a public authority intends to initiate a PPP or concession contract as impact of the taxes on the project is crucial, given that project needs to fulfil the affordability criteria in order to be initiated and implemented.

KEYWORDS: *Public-private partnership, project company, profit tax, value added tax, local tax, construction tax*

1.Introduction

The taxation regime applicable to companies is studied and analysed in different school books and articles. A company established during a concession contract or a PPP project may require a specific and detailed analysis in order to identify all the potential tax issues that may occur.

Currently, the development of public projects in Romania can be done either:

- by public procurement of works, when the necessary financing exists, from public funds from the state budget or from external funds or
- by entering into a public works concession contract under Chapter VII, articles 217-228 of the Government Emergency Ordinance no. 34/2006 regarding the award of public procurement contracts, public works concession contracts and services concession contracts, as supplemented and amended ("GEO 34/2006"[1]), when private funds are used, as the necessary financing from public funds does not exist or
- by entering into a public-private partnership contract as regulated by Law no. 178/2010[2] on Public-Private Partnership, as subsequently amended (hereinafter "Law no. 178/2010" or "PPP Law'). In the near future, it is possible that a new law related to the public-private partnership[3] will enter into force.

Either in a concession contract or a public-private partnership contract, the contracting parties may decide to setup a company which shall be registered according to the provisions of Companies Law no. 31/1990[4], as subsequently amended (hereinafter "Law no. 31/1990").

As it has been previously mentioned[5] in the academic literature, the public-private partnership contract is a form of cooperation between public authorities and private investors, not to be confused neither with the concession contract nor with the public procurement contract. A PPP project shall be made only of the results of economic analysis made by the public

[1]Government Emergency Ordinance no. 34/2006 regarding the award of public procurement contracts, public works concession contracts and services concession contracts was published in the Official Journal of Romania, Part I, no. 418 of 15 May 2006 and was approved by Law no. 337/2006 published in Official Journal of Romania, Part I, no. 625 of 20 July 2006.

[2]Public-Private Partnership Law no. 178/2010, published in the Official Journal of Romania, Part I, no. 676/2010, amended by Emergency Government Ordinance no. 39/2011, published in the Official Journal of Romania, Part I, no. 284/2011 and by Emergency Government Ordinance no. 86/2011, published in the Official Journal of Romania, Part I, no. 729/2011.

[3]The project was adopted and sent for promulgation on 17 December 2013. Further to the re-examination request formulated by the President of Romania the project is under debate again in the Parliament.
http://www.cdep.ro/pls/proiecte/docs/2013/pr457_13.pdf.

[4]Companies Law no. 31/1990, republished in the Official Journal of Romania, Part I, no. 1066 of 17 November 2004, as subsequently amended and completed. Please note that the latest amendment of Law no. 31/1990, until the date hereof, was made by Law no. 71/2011 for the application of Law no. 287/2009 on the Civil Code, published in the Official Journal of Romania, Part I, no. 409 of 10 June 2011.

[5]Rațiu, A. M., Gherghina, S. 2011 "*Comments and Annotations to the Public-Private Partnership Law*", Bucharest, Romania: R.A. Official Journal, p. 30, et seq.

partner are in accordance with the international parameters[6].

At the time of the prefeasibility study of the project, all tax issues arising from the implementation of a concession project or public-private partnership should also be reviewed, as the value of taxes and fees due to the state budget or to local budgets can be a major cost to the private partner.

A proper analysis of the tax impact includes profit tax, values added tax[7], local taxes, and the construction tax, a tax introduced in 2013 and still in force at the date of this article. The importance of this analysis was also highlighted by the European PPP Expertise Centre (EPEC), which, in July 2013, published a report entitled "*VAT and PPP Contracts. Review of key issues arising in the European context*"[8] as the PPP contracts are "long-term arrangements".

2.Theoretical issues

As mentioned above, should the necessary financing exists the development of a public project is done by public procurement of works. In this case, no specific tax impact to be analysed in relation to the contracting parties.

If there is no public funding or the amount is limited, the public authority may decide to enter into a public works concession contract under Chapter VII, articles 217-228 of the GEO 34/2006 or into a public-private partnership contract as regulated by PPP Law.

In any of these two situations, the contracting parties may decide to establish a new entity, called the "Project Company". There is no specific definition for the Project Company in GEO 34/2006 but there is a definition in the PPP Law. The legal definition of the "Project Company" is: "*a company, Romanian legal person, whose shareholders are the public partner and the private partner, represented proportional with their participation to the public-private partnership project, the public partner participating with in-kind contribution*".

The solution adopted by the Romanian legislator is compliant with the European Commission's proposals included in the *Commission Interpretative Communication on the application of Community law on Public Procurement and Concessions to Institutionalized Public-Private Partnerships (IPPP)*[9].

Both the public partner and the private partner have the obligation[10] to contribute to the share capital of the project company, which is a joint stock company established. But unlike the classic joint stock company, the public partner in the project company participates only with in-kind contribution, the private partner having the possibility to participate both with in-kind contribution, and with cash or receivables[11], the latter

[6]Farquharson, E., Torres de Mästle, C., Yescombe, E. R., Encinas, J. 2011. *How to engage with the Private sector in Public-Private Partnerships in Emerging Markets*, World Bank; European PPP Expertise Centre – EPE. 2011. *The Guide to Guidance. How to Prepare, Procure and Deliver PPP Projects*, published by (http://www.eib.org/epec/ resources/ guide-to-guidance-en.pdf.)

[7]Anghel, D. *Fiscal aspects regarding how to implement a public-private partnership project*, published in Romanian Public-Private Partnership Law Review, no. 3/2012, p. 58.

[8]http://www.eib.org/epec/resources/vat-ppp-report-july-2013.pdf

[9]Published in the Official Journal of the European Union C91/4 of 12 April 2008

[10]Raţiu, A. M., Gherghina, S. 2011 "*Comments and Annotations to the Public-Private Partnership Law*", Bucharest, Romania: R.A. Official Journal, p. 320, et seq.

[11]According to Article 16(3) of Law no. 31/1990 "Receivables contributions have

being brought on the condition that the joint stock company is not established by public subscription.

Since a new company will established the shareholders should evaluate all the possible costs including the tax costs.

3.Tax regime

3.1.The profit tax rules applicable to the Project Company's share capital

The analysis of the provisions of Law no. 178/2010 indicates that the private partner's contribution to the Project Company's share capital may take any of the forms provided by Companies Law no. 31/1990, *i.e.* cash contribution, in-kind contribution or receivables. As to the contribution in kind, two aspects require clarification whether the assets contributed by the private partner to the project company generate a taxable transfer from a tax on profit point of view, and whether the assets contributed by the private partner to the project company are subject to the application of the value added tax.

The contribution in-kind or receivables made by the private partner to the project company's share capital are treated, from the tax on profit perspective, as non-taxable transfers[12], which means that neither the legal entity receiving the assets, nor the private partner receiving the shares has the obligation to pay tax on profit.

Art. 33 of Law no. 178/2010 stipulates: "*The project company operates throughout the entire term of the public-private partnership contract and is liquidated according to law, upon its termination*". The criticism formulated in the doctrine regarding the project company's liquidation in all cases of termination of the public-private partnership are fully justified, if we consider both, the inconsistency of the terms used by Law no. 178/2010 with reference to the provisions of Law no. 31/1990 and the applicable fiscal regulations, as detailed below.

Art. 227 par (1), letter a) of Law no. 31/1990 provides that a company is dissolved upon the expiry of the company's duration, while article 233 of the same law provides for that the effect of the dissolution is the initiation of the liquidation procedure. The corroborated interpretation of these texts reveals that the term that should be used in Law no. 178/2010 is that of dissolution. As indicated in the doctrine, the solution chosen by the lawmaker is not the most adequate one, this argument being also supported by the fiscal provisions applicable to the dissolution followed by liquidation as discussed below.

According to article 27 par (2) of the Tax Code from the tax on profit perspective, any distribution of assets by the project company to its shareholders, whether in the form of dividends or as a result of liquidation operation, is treated as taxable transfer. From a tax perspective, the inclusion of such distributions in the category of taxable transfers means that, at the time of distribution, the project company has the obligation to calculate related tax on profit and tax on dividends, as the case may be.

the legal regime of in-kind contributions, and are not admitted in the case of joint stock companies established by public subscription, or partnerships limited by shares and limited liability companies. According to Article 84, receivables contributions are liberated."

[12]Article 27(1) of Law no. 571/2003 on the Fiscal Code, as subsequently amended and completed

3.2.The value added tax rules applicable to the Project Company's share capital

Related to the application of the value added tax, article 128 par (7) of the Tax Code provides that the transfer of assets following an in-kind contribution to the share capital of a legal entity is not a taxable operation, if the recipient of the assets is a person registered as a value added tax payer.

Although contributions in-kind or receivables made by the private partner to the project company's share capital may be considered, from a legal point of view, as a delivery of goods for the purpose of article 128 par (1) of the Tax Code, they are, however, not subject to value added tax regulations if the project company is not registered as a value added tax payer or registers following such operation, due to the fact that it represents a transfer of the right to dispose of an asset as owner.

The application of this tax treatment provided by the Romanian legislator takes into consideration the practice of the European Court of Justice laid out in the Judgment of 27 November 2003 in the Case C-497/01 – Zita Modes. Thus, the Court of Justice explicitly established that an assets transfer operation is not a delivery of goods subject to the value added tax, if the recipient of the assets intends to carry out the transferred economic activity and does not liquidate such activity immediately[13].

At the time of liquidation the project company has the obligation to calculate and transfer to the state budget also the value added tax related to the assets distributed to the shareholders. Art. 128 par. (5) of the Tax Code stipulates explicitly that any distribution of assets to shareholders, from the project company's assets, represents a supply of goods against payment, provided that the tax applicable to such goods or to parts thereof was deducted in whole or in part.

Thus, in case of a positive result of the liquidation of assets, and if the project company's shareholders establish by decision of the general meeting of the shareholders to split such assets between the shareholders, the distribution of assets is subject to value added tax. The project company issues the relevant invoices and has the obligation to transfer such tax to the state budget.

3.3.Local taxes owed by the Project Company

Depending on the ownership of the assets involved in a public-private partnership project, the provisions of the Tax Code on land or buildings tax are incidental.

The public partner may decide to bring as contribution to the project a plot of land or a building which can legally lead to one of the following situations:

- the transfer of ownership title from the public partner to the project company, if the property is privately owned by the public partner or
- the establishment of a legal right which provides the transmission of usage in favour of the project company or the private partner.

In any of the above mentioned situations the Project Company or private partner will have to pay the local land or building tax. When the public partner performs the prefeasibility study of the PPP project this issue needs to highlighted, as may subsequently have an impact on the economic efficiency of the project. As long as the property (land or construction) is owned by the public partner which is not using it for business activities, other than

[13]Judgment of November 27, 2003 ruled in the Case C-497/01 Zita Modes Sarl and Administration de l'enregistrement et des domaines, Paragraph 46.

those conducted in relation to legal public persons, no land and building tax or construction tax is due for that property.

If the public partner brings a building, as contribution in kind to the constitution of the share capital of the company, then the ownership is transferred to the company, which means that the new owner has the obligation of paying tax on the building.

If the public partner has a right which ensures the transfer of usage in favour of the project company or of the private partner, then the general rule laid down in art. 249 par. (3)[14] of the Tax Code is applied. The project company is legally obliged to pay tax on buildings, which represent the tax burden of the concessionaires, lessees, holders of the right of administration or use, where appropriate, under similar conditions, tax on buildings. If the project company, as concessionaire or holder of the right of administration or use, transfers this right to other legal entities, the tax on buildings will be due by the end user.

It is important to include the value of the tax in the economic analysis performed by the private partner previous to involvement in a PPP project, as there have been situations within concession projects when the involved economic operator had failed to include in the calculation the value of this tax across the length of this concession, an aspect which has had a significant impact on the profitability of the concession at the time of the "discovery" of this obligation.

Of course this analysis is not particularly relevant to the public partner since, as a rule, the buildings owned by the public partner are included in one of the categories of exemptions provided by the Tax Code.

If the project company acquires ownership of the assets erected under the concession or PPP contract then it may also owe construction tax, as regulated currently in the Tax Code, but this analysis will be carried out in the chapter on construction tax.

3.4.Land tax

If the project company acquires ownership of a plot of land, then it has the obligation to pay land tax in the month following the one in which it acquired the property. Obviously, the transfer of ownership of the land can only be achieved if the land in question is privately owned by the state or the territorial - administrative unit involved.

Similar to the tax on buildings, article 256 par (3) of the Tax Code provides the obligation for payment of land tax by legal persons who act as a concessionaire, lessee or holder of the right of management or land use for public or private property of the state or territorial-administrative units, leased, rented, given towards administration or in use.

Also in the case of land, as a rule, the public partner is exempt from tax, including for the land under the management or use of a public institution, if the land is not used for economic activities.

It is very interesting to analyse a public-private partnership project whose object is the construction and operation of highways, from this perspective. The

[14] Art. 249 par. (3) of the Tax Code "In the case of a building that is under the public or private property of the state or of territorial-administrative units under concession, rent, administration or use, as the case may be, to the legal persons, other than those of public law, the tax on buildings is established, payable by the concessionaires, tenants, owners of the right of administration or use, as the case may be, in similar conditions to the building tax."

private partner must take into account the value of this tax on the land occupied by the highway when they set the budget for the contractual period, regarding the exploitation of the built highway. The land highway occupies is public property of the state, so the state also transfers a concession or use of the land right to the highway operator. However, the exemption provided for by article 257 of the Tax Code refers to the hypothesis of lands containing highways that is managed by the Romanian National Company of Motorways and National Roads – S.A. Consequently, if the administrator is a different legal person, then that administrator will owe tax on the land, according to art. 256 par. (3) of the Tax Code. Obviously, the impact on the profitability of the project can be significant, if such an analysis is omitted.

Even if the land is state property, the land tax is determined by taking into account the rank of the region where the land is located and/or land use category according to the classification made by the Local Council for each region.

3.5.Construction tax

Government Emergency Ordinance no. 102 of 14 November 2013[15] has included a new tax called "construction tax" in the Romanian tax system, in force starting 1 January 2014.

The subjects of taxation are Romanian legal persons, foreign legal persons that operate through a permanent establishment in Romania as well as legal persons with registered office in Romania, established according to European legislation. In the case of financial leasing operations, the quality of taxpayer is attributed to the user, and in the case of operating leases operations, the quality of taxpayer is attributed to the lessor. Public institutions, national research and development institutes, associations, foundations and other non-profit legal persons, under the law of organization and operation, are exempt from this tax.

The object of taxation are those construction values established in Group 1 of the Catalogue on the classification and normal operation duration of the fixed assets, approved by Government Decision no. 2.139/2004, as amended[16].

The construction tax expense is the deductible expense in determining taxable company income by the taxpayer.

The publication of this tax raised comments from the tax people and public debates related to the fiscal impact on the business in Romania. Obviously, the value of this tax need to be included in the

[15]Government Emergency Ordinance no. 102/2013 amending and supplementing Law no. 571/2003 regarding the Fiscal Code and the regulation of financial-fiscal measures was published in the Official Journal of Romania, Part I, no. 703 of 15 November 2013.

[16]Government Decision no. 2.139/2004 for approving the Catalogue regarding the classification and the normal operation period of fixed assets was published in the Official journal of Romania, Part I, no. 46 of 13.01.2005 and it has never been changed until now. For those who have not had the curiosity to examine this document, I assume that even those who have had the initiative have not studied very much, this bill includes the classification of fixed assets and their normal operational periods that correspond with payback in years, corresponding to the linear depreciation regime. As stated at paragraph 3 of the Catalogue, the fixed assets have been categorized into three main groups as follows: Group 1 - Construction; Group 2 - Technical installations, vehicles, animals and plantations; Group 3 - Furniture, office equipment, equipment for the protection of human and material values and other tangible assets.

economic analysis as it is required to show the financial capacity of the private partner to develop the project and to cover all costs during the life of the PPP contract.

4.Conclusions

Performing a correct tax analysis for any project is extremely important, but in the case of a concession or a public-private partnership project is crucial, given that the private partner will cover, at least in theory, a great part of the project costs.

But the importance of this analysis to the prefeasibility study conducted by the public partner is especially evident when the public partner is obliged to make certain payments of availability during the public-private partnership contract.

Obviously, not including these amounts at the moment of substantiation will lead to an unexpected cost during the contract and payments higher than originally anticipated.

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