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Doing Mergers & Acquisitions in Romania 2013/2014

Romania is an M&A friendly jurisdiction.

This is a reality anchored in four major pillars consisting of (i) a stable and predictable applicable legal framework, (ii) the related quasi-low tax treatment, (iii) pragmatic merger control regulatory functions and (iv) legally-manageable labor resources. As legal stability and predictability of the local framework are secured by and through the EU membership status, this area does not require additional development for the herein purposes. We will then focus in this paper on the remaining three major factors, related to tax treatment, merger control and labor relations.

Romania: a quasi-low tax jurisdiction and a platform for deal structuring

Acquisition, establishment or merger opportunities may be structured locally with high level of tax optimization on grounds of: (i) one of the Europe's lowest corporate income tax rate of 16% only, (ii) an extensive network of Conventions for the avoidance of double taxation (more than 80 up to date), which includes favorable Conventions with "white list" low-tax holding jurisdictions such as Cyprus, the Netherlands and Luxembourg and (iii) available benefits under the EU legislation (including the Parent Subsidiary, Interest and Royalty and Merger Directives), which entails possibilities for tax efficient structuring. In addition, VAT grouping is available, at least partially in certain conditions. Finally, the accounting legislation is harmonized with the IV EU Directive and selected entities (financial institutions and listed companies) are subject to IFRS.

At a technical level, a share deal structure is usually preferred due to its immediate cash-flow advantage (propelled by the VAT not being applicable) but also because of enabling more flexible exit strategies. However, given a certain "cultural tax deferral approach" taken in many local businesses, old targets are likely to be tax burdened. Therefore, extensive fiscal due diligence exercises are a "must" in almost all cases. This is more so when combined with mergers, or even when mergers are considered as a stand-alone investment alternative.

Asset deals provide an opportunity for "cherry picking", but they may entail an additional cash-flow burden generated by VAT. To mitigate or even relinquish such risk, the possibility of qualifying the transaction as a transfer of business as a going concern (outside the scope of VAT) should be considered. In addition, although asset deals are used as an alternative to avoid taking over the fiscal liabilities of the Target, in specific circumstances, a joint liability (for VAT and/or other fiscal liabilities) may still arise for the acquiring entity.

One of the investment structures preferred and applied with success in recent years consists in acquisition of local old targets through locally incorporated new companies followed by a step-up merger. An asset-deal component structured as a going concern transfer is interposed sometimes. Such a formula offers not only a lower immediate tax impact and the possibility of a better investment book building and consolidation, but also a better planning of tax losses (i.e. fiscal loss of the absorbed company can be taken over by the absorbent company).

In addition, certain tax incentives apply to capital gains, dividends and corporate liquidation proceeds may be secured in specific cases, subject to qualifying procedures. In the same vein, within corporate reorganizations processes, tax deductible expenditures, such as losses with interest rates and FX-rate differences in relation to loans may be taken over into the resulting entities, at least on a pro-rata basis with transferred assets and passives. For partial spin-offs, taking over the losses is possible only if the taken over assets and liabilities qualify as a whole to be operated as such.

Romania: a pragmatic merger control process

With almost two decades of practice and some very intense recent years of applying the EU Merger Control Regulation of 2004 and subsequent guidelines, the Romanian merger control authority – the Competition Council – has reached now the era of legal pragmatism and efficiency. M&A activities are thus if not supported by the regulator, at least not hindered as in certain past years.

Specifically, the Romanian merger control system comes into play if four conditions are met. First, the relevant transaction must take place between independent entities. Internal group restructurings are not subject to merger control rules. Second, the transaction must lead to a long lasting change of control over the acquired company or business. Third, the transaction must not fall within the competence of the European Commission, by essentially being below the turnover requisites provided by the EU Merger Control Regulation. And fourth, the transaction must meet the following turnover thresholds in the previous year: (i) the aggregate turnover of the parties involved was above €10 million and (ii) at least two undertakings concerned recorded a turnover in Romania exceeding €4 million each. Concentrations meeting the above conditions must be notified and cleared by the Competition Council before their implementation. Failure to do this may trigger fines on the acquirer(s) ranging between 0.5% and 10% of the total turnover achieved in the previous financial year.

Romanian legally-manageable labor resources

Within mergers and acquisitions context, in specific language, in the event of transfers of undertakings, businesses or parts of undertakings or businesses, the Acquired Rights Directive (Directive 2001/23/EC) relating to the safeguarding of employees' rights shall be considered as fully transposed in Romania. Although it entails a very cautious and formally compliance process, if well prepared and properly implemented, dealing with the labor resources within M&A activities remains legally manageable in Romania.

In terms of M&A related tips, when conducting employment due diligence, following areas prove hot an shall be given special attention (i) conciliation between individual employment contracts and collective labor relations (if applicable) and related salary practices, (ii) health and safety compliance, involving mandatory documentation, appointment of specialized personnel or outsourcing to authorized providers, performance of periodic trainings, etc. In terms of salary practices, particular importance will be given to special non non-compete clauses and related bonus arrangements imposing payment obligations on the employer, as well as to the “mandatory” types of add-ons, bonuses and other indemnities (such as those paid for work rendered during week-ends). The review of the collective labor relations shall consider (i) the forms of employees' representation that include employees' representatives or trade unions, and affiliations to trade union federations, as well as (ii) extent of add-ons secured through the arrangements at the concerned industry level and (iii) on resolution mechanics of any collective labor disputes.

Above-summarized traits of the Romanian M&A legal framework has helped this jurisdiction not to lose major investments during the financial turmoil and are a key support in the current recovery of investors' appetite.

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