In this issue:

Reclassification of Intra-Group Loans: Impact on Interest and Withholding Taxes (WHT)

I. Turn an area of tax uncertainty into a documented and defensible position

Intra-group financing arrangements are increasingly reviewed by tax authorities from the perspective of economic substance and transfer pricing rules. In certain cases, tax authorities may determine that part of a loan granted by a non-resident affiliated entity does not reflect arm's-length conditions and may therefore be reclassified for tax purposes as an equity contribution.

Such reclassification affects, on the one hand, the deductibility of interest expenses at the level of the Romanian company. In addition, it may raise a separate issue with equally significant financial implications, namely: **if the financing is no longer treated as a loan for tax purposes, how should the amounts related to this component be treated from the perspective of WHT?**

II. Why is this relevant?

- The tax treatment applied to interest paid or capitalized in favor of non-resident affiliated entities may be challenged during tax audits, especially where intra-group financing is analyzed using indicators such as leverage ratios, debt capacity, interest/EBITDA ratios, loans/EBITDA ratios, or loans/tangible assets ratios.
- If the tax authority reclassifies the loan as an equity contribution, tensions may arise between the corporate income tax treatment and the treatment applicable for WHT.
- The absence of explicit clarification in the Fiscal Code may lead to inconsistent tax treatment, risks of double taxation, disputes regarding the application of double tax treaties, and possible asymmetric treatment in the jurisdiction of the non-resident lender.

III. Actions to Take Before a Tax Audit

- Review existing and historical intra-group loans from the perspective of potential tax reclassification risks.
- Assess transfer pricing documentation related to intra-group financial transactions, including debt capacity analyses and the arm's-length nature of the financing.
- Verify the tax treatment applied to interest paid or capitalized in favor of non-residents, both from the perspective of corporate income tax and WHT, including the application of double tax treaties and any available exemptions or reduced tax rates.
- Analyze how interest related to the reclassified amounts may be treated for tax purposes if the financing is reclassified as an equity contribution.
- Prepare a well-documented and coherent technical position before a tax audit or during tax appeals and litigation.

IV. How Deloitte Can Help

Deloitte's multidisciplinary team of tax advisers and lawyers specializing in tax disputes related to such reclassifications can assist you with assessing risks associated with intra-group financing, reviewing corporate income tax and WHT, preparing technical arguments, supporting your position in interactions with the tax authorities, eliminating double taxation arising from reclassification, and providing assistance and representation in ongoing tax disputes before courts or during administrative proceedings.

We recommend that you **assess in advance the potential impact of reclassification of intra-group loans** on interest paid to non-residents, in order to reduce the risk of **significant tax adjustments and inconsistent tax treatment**. Furthermore, for taxpayers already involved in **tax audits, administrative appeals, or litigation** regarding interest deductibility, transfer pricing, or WHT, we recommend carrying out a dedicated analysis to support the company's position in the ongoing proceedings.

For more details, please feel free to contact us.

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