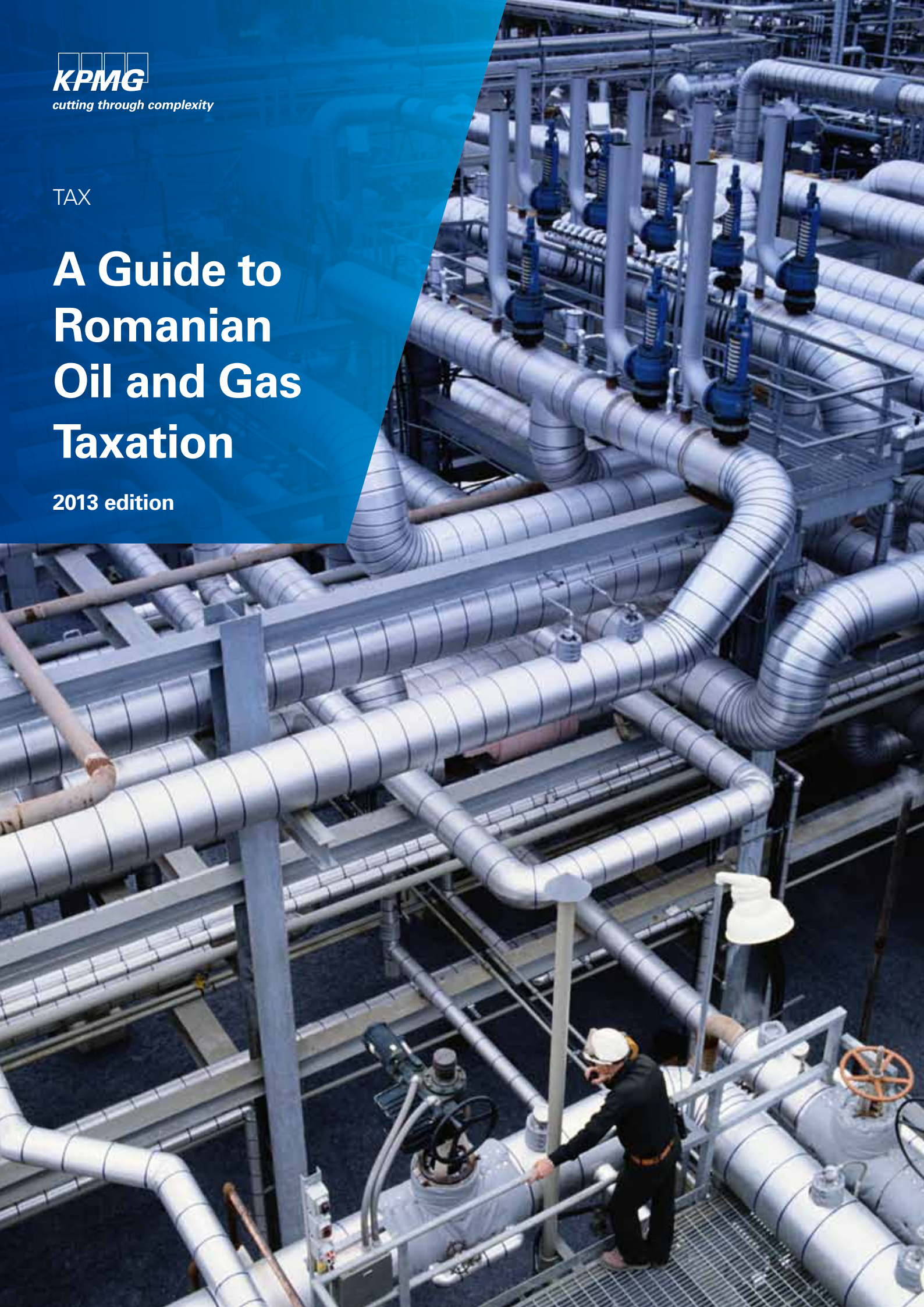


TAX

A Guide to Romanian Oil and Gas Taxation

2013 edition



About this book

This book is a general guide to Romanian oil and gas taxation as it affects companies involved in oil and gas exploration and extraction activities. The Guide sets out the current law, forthcoming legislation and prevailing practice as at 15 November 2013.

It is designed to bring out the main features of the legislative framework, to provide broad practical guidance and to identify some of the problems likely to be encountered. It is not intended, however, to be comprehensive or to provide answers to particular problems and should not be regarded as a substitute for professional advice.

Further professional tax advice on specific matters may be obtained from KPMG.

Foreword

Welcome to the first edition of the KPMG Guide to Romanian Oil and Gas Taxation. This year has seen considerable changes to the Romanian upstream taxation system, as new rules have been put in place introducing extra taxation for companies in the energy sector. The next year will similarly see many changes with the most significant being the potential introduction of new rules applicable to joint ventures.

Whether you intend to invest in Romania and are looking for an easy to read guide or have been active in Romania for a while and are just looking to refresh your understanding of the tax issues, we hope you find our Guide useful.



Ramona Jurubiță

Partner,
Deputy Head of Taxation Services



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Part I

General aspects



Throughout the world, the oil and gas sector is facing unprecedented change and challenges. Businesses in this sector need forward thinking advice and practical strategies from professionals who understand their business and the current issues faced by the industry.

History of the oil and gas industry in Romania

Romania has a long and outstanding history of developing the oil and gas sector. Here are a few highlights:

1935 – Romania became the 6th largest oil producer in the world – 8.4 million tonnes.

1976 – Romanian oil production reached its peak– 14.6 million tonnes.

1986 – Natural gas production in Romania reached its peak- 36 billion cubic meters.

2012 – New reserves of natural gas were found in the Romanian sector of the Black Sea.

Romania's oil reserves

At end 1992 (thousand million barrels)	At end 2002 (thousand million barrels)	At end 2011 (thousand million barrels)	At end 2012 (thousand million barrels)	Years of remaining reserves (reserves/ production ratio at end 2012)
1.2	0.5	0.6	0.6	19.1

Source of data – www.namr.ro, BP Energy Statistical Review 2013



Romania's oil production and consumption

Year/thousand barrels daily	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2012 (share of total worldwide)
Production	128	124	120	114	105	100	99	94	90	89	86	0.1%
Consumption	220	194	224	218	214	218	216	195	184	191	182	0.2%

Source of data – BP Energy Statistical Review 2013

Romania's natural gas reserves

At end 1992 (trillion cubic meters)	At end 2002 (trillion cubic meters)	At end 2011 (trillion cubic meters)	At end 2012 (trillion cubic meters)	Years of remaining reserves (reserves/production ratio at end 2012)
0.5	0.3	0.1	0.1	9.3

Source of data – BP Energy Statistical Review 2013

Romania's natural gas production and consumption

Year / Billion cubic meters	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2012 (share of total worldwide)
Production	13.2	13	12.8	12.4	11.9	11.5	11.4	11.3	10.9	10.9	10.9	0.3%
Consumption	17.2	18.3	17.5	17.6	18.1	16.1	15.9	13.3	13.6	13.9	13.5	0.4%

Source of data – BP Energy Statistical Review 2013

Part II

Summary of Romanian tax legislation



Tax rates at a glance

// Companies operating in the oil and gas market are normally subject to Corporate Income Tax, royalties, VAT, and potentially WHT. //

Type of tax	Rate
CIT	16%
Royalties	3.5% to 13.5% royalty for exploitation, depending on the gross production.
	3% applicable to gross income derived from underground storage of gas.
	10% applicable to gross income derived from transportation and transit of the petroleum through the national systems of petroleum transportation, as well as to the gross income derived from petroleum operations made through oil terminals owned by the state
WHT	16%
VAT	24%



Companies operating in the oil and gas market are subject to CIT and the normal rate of taxation is 16%. //

Corporate income tax

Companies operating in the oil and gas market are subject to Corporate Income Tax (CIT) and the normal rate of taxation is 16%. However, due to the limits on deducting certain categories of expenses, the effective tax rate is generally higher.

The rule above applies similarly to legal entities and branches / permanent

How much	How to calculate taxable profit
16% CIT applied to the taxable profit	Taxable profit = Total income - Total expenses + Non-deductible expenses - Non-taxable income

establishments. The main difference is the taxable base: worldwide income for legal entities, whereas branches / permanent establishments are only subject to Romanian tax on the income derived from Romania. We have enclosed a more detailed comparison between these two taxable presences in the Appendix to this Guide.

Non-taxable revenues

As a general rule, revenues are subject to tax unless specifically indicated as being non-taxable. The most relevant types of non-taxable revenues for oil and gas companies are:

- Dividends received from other Romanian subsidiaries until 31 December 2013.
- Dividends received from foreign subsidiaries if the conditions of the EU Parent Subsidiary Directive are met (e.g. 10% shareholding for at least 2 years) until 31 December 2013. As of 1 January 2014, this rule has been amended. Thus, dividends received from subsidiaries are non-taxable revenues, if the subsidiary is subject to CIT or other similar tax, is resident in Romania or in a DTT country and a 10% shareholding has existed for at least one year.
- Revenues from reversal or cancellations of provisions / expenses that were previously non-deductible, as well as recovery of expenses that were previously non-deductible.
- Some types of income resulting from taxpayers (listed companies) switching to International Financial Reporting Standards.
- Starting 2014, revenues derived from the sale or transfer of shares and proceeds from liquidation, provided the subsidiary is located in Romania or in a DTT country and a 10% shareholding had been in existence for at least one year.



Deductibility of expenses

As a rule, expenses are deductible only to the extent they were incurred for the purposes of deriving taxable income. Supporting documents are required to claim the deduction.

Specific rules exist regulating the deductibility of expenses. Thus, expenses are divided into three categories: deductible expenses, limited deductibility expenses and non-deductible expenses.

Limited deductibility expenses

These include:

- Interest and foreign exchange losses under thin capitalisation rules (see details below).
- Depreciation of assets under tax depreciation rules (see details below).
- Entertainment expenses (deductible up to 2% of the difference between total taxable revenue and total expenses related to taxable revenue, adjusted with the protocol and CIT expenses).
- Social expenses (deductible up to 2% of salary expenses).
- Expenses related to company vehicles, other than depreciation (50% deductible if not used exclusively for business purposes). Tax depreciation for cars is also limited in certain cases to a maximum of RON 1,500 per month.

Non-deductible expenses

These include:

- Domestic profit tax and profit tax paid in foreign countries.
- Withholding tax paid by Romanian taxpayers on behalf of non-residents.
- Interest, fines and penalties payable to Romanian or foreign authorities.
- Expenses incurred from management, consultancy, assistance or other supplies of services if no contracts or any other lawful agreements are entered into and the beneficiary cannot justify the supply of these services for the activities performed and their necessity.
- Sponsorship expenses. Taxpayers are, however, granted a fiscal credit up to whichever is the lower of 0.3% of turnover or 20% of the profit tax due. Starting 1 January 2014, a new facility has been introduced allowing for carrying forward for a period of 7 consecutive years of amounts representing sponsorship expenses which have not been deducted for CIT purposes.
- Other salary and/or similar expenses (if not taxed at the level of the individual), except for those specifically exempted from individual income taxation.

Companies operating in the oil and gas market should be careful with gathering supporting documents .

Expenses related to the acquisition of any right to exploit natural resources are recovered as the natural resources are exploited. //



Financing

Financing can be made via debt, equity or a combination of the both. For debt financing, the following limitations exist.

Interest expenses for loans from financial institutions	Interest expenses for loans from non-financial institutions
Fully deductible	<p>Interest rate limitation – 6% for loans denominated in foreign currency/ the reference interest rate published by the National Bank of Romania for loans denominated in RON. Interest expenses exceeding the limits are permanently non-deductible.</p> <p>Debt-to equity limitation – if the debt-to-equity ratio is greater than 3:1 or equity is negative – interest expenses and net foreign exchange losses related to loans are non-deductible, but can be carried forward indefinitely and deducted when the conditions are met.</p>

Tax depreciation

Specific tax depreciation rules are set out for Romanian taxpayers and the deductibility no longer depends on the level of depreciation recorded in the accounts.

Expenses related to discovery, exploration, development or other activity that is preparatory to the exploitation of natural resources is recovered in equal amounts over a period of 5 years, beginning with the month when the expenses are incurred. Expenses related to the acquisition of any right to exploit natural resources are recovered as the natural resources are exploited, based on the proportion of the value of resources recovered to the estimated value of resources.

For titleholders of petroleum agreements and their subcontractors that carry out petroleum operations in maritime areas (including water deeper than 100 meters), the depreciation of tangible and intangible assets related to petroleum operations, for which the period of use is limited to the period of the reserve, for each unit of product with a degree of use of 100%, is computed based on the exploitable reserve of useful mineral substance, over the period of the petroleum agreement.

// A 50% WHT rate is applicable for income paid for transactions that are classified as artificial in a country with which Romania has not concluded a treaty for the exchange of information //

Provisions and reserves

As a general rule, expenses involving provisions set-up by taxpayers are non-deductible.

Titleholders authorized for exploitation of natural resources are required to record a provision for rehabilitation of polluted land, within the limit of 1% of the difference between income registered from realisation and sale of natural resources and expenses incurred for their extraction, exploitation, and delivery, during the entire period of the operation and exploitation of natural resources. This provision is deductible for CIT purposes.

Titleholders of petroleum agreements, which have petroleum operations in maritime areas (including water deeper than 100 meters) have to record a provision for wells disposals, decommissioned plant and outbuildings as well as for environmental rehabilitation of 10% of the difference between income and expenses incurred for the exploitation for the entire period of the exploitation. This provision is also deductible for CIT purposes.

Withholding tax (WHT)

Generally, revenues obtained from Romania by non-resident legal entities are subject to Romanian WHT, at the standard 16% rate.

Revenues subject to WHT include service fees (if services are provided on Romanian territory), royalties, interest, commissions, and dividends. Payments for some specific types of services are subject to WHT, even if the place of their supply is outside Romania. These services include: management services, consultancy in any field of activity, marketing services, technical assistance services, research and design services in any field of activity, advertising services irrespective of the form in which they are realized, as well as services rendered by lawyers, engineers, architects, notaries, accountants and auditors.

A 50% WHT rate is applicable for income paid for transactions that are classified as artificial in a country with which Romania has not concluded a treaty for the exchange of information.

The WHT rate can be reduced based on Double Taxation Treaties (DTTs) concluded by Romania. Romania has DTTs with over 80 countries and these may allow non-residents to be taxed at a reduced rate, or to be exempt, subject to certain conditions being fulfilled (e.g. presenting a certificate of tax residence). DTT relief can be denied for transactions deemed as artificial.



Transactions in the oil and gas industry are complex and standard transfer pricing methods are generally difficult to follow.

Dividends

16% WHT generally applies, which can be reduced under the relevant DTT.

According to the Parent-Subsidiary Directive, which has been implemented into Romanian legislation, payment of dividends made by a Romanian company to a non-resident shareholder (based in an EU or EFTA member state) is exempted, provided the shareholder has held at least 10% ownership for an uninterrupted period of at least 2 years at the date of the dividend payment.

Starting 2014, the minimum holding period would be reduced to 1 year, while the exemption would only apply to payments made to shareholders based in an EU member state.

Interest and royalties

16% WHT generally applies, which can be reduced under the relevant DTT.

Under the Interest and Royalties Directive, interest or royalties payments are exempted from WHT in Romania if the recipient is a resident of another EU or EFTA state, subject to the condition of direct ownership of at least 25% / having a parent which holds at least 25% of both the paying company and the beneficiary for an uninterrupted period of at least 2 years at the date of the royalty or interest payment.

Starting 2014, the WHT exemption would only apply to payments made to a beneficiary based in an EU member state.

Transfer pricing

Romanian legislation has specific transfer pricing regulations. All related party transactions should be carried out by observing the arm's length principle and the local entity should have available a TP documentation file to demonstrate that the intra-group transactions are at market value. The prices set for transactions with goods (such as gas or crude oil) generally follow quotations published on the stock exchange market. However, the methodology for adjusting the public quotation depending on the specifics of each transaction and the economic circumstances applicable is usually complex and difficult to document. Taxpayers may obtain Advanced Pricing Arrangements for any intended transaction.

The OECD Transfer Pricing Guidelines are generally recognized by Romanian transfer pricing legislation. However there are certain requirements which are specific for Romania.



During the exploration phase, due to the lack of income, companies established in Romania acting in the oil and gas industry are likely to apply the VAT cash accounting system until they exceed a turnover of EUR 500,000, (i.e. 2,250,000 RON).

VAT

Romanian VAT legislation is based on the EU VAT Directive. The standard VAT rate in Romania is 24%. This is levied for all supplies of goods and services, including imports, which do not qualify for an exemption (with or without credit) or for the reduced VAT rate.

If your company is involved in oil and gas operations in Romania, it is likely that you will have to register for VAT purposes. As a general rule, legal entities or individuals registered for VAT purposes in Romania may deduct the Romanian input VAT related to their acquisitions. Deductible input VAT may be offset against the VAT collected by the taxable person (output VAT).

Also, during the exploration phase, due to the lack of income, companies established in Romania acting in the oil and gas industry are likely to apply the VAT cash accounting system until they exceed a turnover of EUR 500,000, (i.e. 2,250,000 RON).

Exploration phase

Until extraction starts – in the exploration, appraisal and development stages – significant amounts of VAT will be accumulated. Given the lack of taxable VAT revenues, this will result in a VAT deferred balance. Two options are available; claiming a VAT refund or continuing to carry forward the balance against VAT liabilities reported in future returns. A VAT refund is generally conditional on a tax audit performed by the tax authorities. The tax authorities are legally required to process claims within 45 days, although in practice they can take much longer.

Extraction phase

VAT applies to goods and services supplied in Romania or in its territorial waters (which extend 12 nautical miles from the coastline). Imports of goods into Romania are typically subject to import VAT and Romanian VAT is normally chargeable on supplies of goods made within Romania.

Exports of goods including oil from Romania to a non-EU destination are zero-rated for VAT purposes. Romanian VAT is not due on movements of oil products to other EU member states as long as the customer is VAT registered in an EU member state other than the country from which the goods are dispatched. Also, as a general rule, Romanian VAT is not due on supply of gas through a natural gas system situated within EU territory or through any other system connected to the afore mentioned one. However, businesses which supply goods including oil from Romania to other EU member states are required to declare these transactions in the VAT return, EC Sales and Purchases lists and probably in the Intrastat dispatch supplementary declarations. The cross-border supply of gas, as mentioned above, does not have to be declared in the VAT return and EC Sales and Purchase list but probably only in the Intrastat dispatch declaration.

Businesses which purchase oil products from other EU member states are required to declare these acquisitions in both the VAT return and the EC Sales and Purchase lists and might also be required to submit Intrastat arrivals declarations.

The cross-border purchase of gas needs to be declared only in the VAT return and the Intrastat arrivals declaration.

Excise duties

Romanian regulations on harmonized excise duties are based on EU excise duty legislation.

Excise duties are due on energy products (such as hydrocarbon oils) used as fuel or for heating purposes in Romania. The rate of excise duty chargeable depends on the type of product and the purpose for which it will be used. In general, the payment of excise duty can be suspended (and thus deferred) by placing the excisable products within a storage tax warehouse (authorised by the relevant authorities). The chargeability of excise duties occurs when the excisable goods are released for consumption, or when losses or shortages are ascertained (e.g. upon exit from the excise duty suspension regime, importation, or when products are lost).

Building tax is not payable for certain special constructions, which include gas and petroleum wells, grids as well as pipe ducts for transportation and distribution of oil products and gas. However, as at 1 January 2014, a construction tax computed as 1.5% of the value of these assets would apply. //

Customs duties

Import duties apply to goods released for free circulation into Romania from outside the EU. The customs duty rates are those applicable at EU level according to the Common Tariff of the EU.

Moreover, excise duties and import VAT become chargeable and should be paid in customs, unless the excisable products (i.e. energy products, including oil, gas, diesel etc) are moved under an excise duty suspension regime (e.g. if the products are dispatched by a registered consignor from the border customs office to a tax warehouse).

Relief from payment of import duties can be obtained if the excisable products are placed under a suspensive customs regime when they are introduced into EU customs territory (e.g. the products are assigned under the inward processing regime with suspension system, are placed under external transit or are introduced and stored in a customs warehouse). In such cases, the payment of excise duty and import VAT is usually suspended as well, but as a general rule, the payment of all these import taxes and duties needs to be secured by providing a guarantee to the customs authorities (e.g. a bank letter of guarantee).

Local taxes

The main local taxes in Romania include

Building tax

This ranges between 0.25% and 1.5% of the building's value if the building is owned by legal entities. These rates are increased for buildings which have not been revalued in the last 3 years and can reach a maximum of 40% for buildings which have not been revalued in the last 5 years.

Building tax is not payable for certain special constructions, which include gas and petroleum wells, grids as well as pipe ducts for transportation and distribution of oil products and gas.

Tax on land

This should be paid on all land owned by taxpayers (fixed amount per square metre – depending on where the land is located).

Construction tax

This will apply starting 2014 and is calculated as 1.5% of the value of constructions owned by taxpayers. The tax does not apply for constructions for which building tax is due or constructions owned by the state or to be transferred to the state. Construction tax will thus be due for gas and petroleum wells, grids, and pipe ducts.



Part III

Specific taxes for the oil and gas sector



Tax on crude oil

Companies are liable to pay crude oil tax for extracted petroleum obtained from domestic production at a rate of EUR 4/tonne applied on the total quantity supplied. However, domestically produced crude oil is exempt if it is exported directly by the producer.

Oil and gas royalty

Royalties applicable for companies in the oil & gas industry are as follows:

Condensed crude oil – production

Royalty level-oil	Gross production / quarter
3.5 %	under 10,000 tonnes
5%	Between 10,000 tonnes and 20,000 tonnes
7%	Between 20,000 tonnes and 100,000 tonnes
13.5%	above 100,000 tonnes

Natural gas – production

Royalty level-gas	Gross production / quarter
3.5 %	under 10 million cbm
7.5%	Between 10 million and 50 million cbm
9%	Between 50 million and 200 million cbm
13%	above 200 million cbm



Extra taxation applies to supplementary income derived following the deregulation of the natural gas price

Oil – transportation

A 10% royalty is applicable to gross income derived from transportation and transit of petroleum through national petroleum transportation systems, as well as to the gross income derived from petroleum operations made through oil terminals owned by the state.

Natural gas – storage

A 3% royalty is applicable to gross income derived from underground storage of natural gas

Extra taxation of companies in the energy sector

As a general rule, all taxes mentioned below will be in force until 31 December 2014, when a change in the royalties system is expected.

Monopoly tax on gas transport and distribution

A monopoly tax is payable by natural gas transport and distribution operators licensed by the NRAE. The tax is applied for each MW/h for which transport and distribution services are invoiced and varies between 0.1 and 0.85 RON/MWh.

Extra taxation

Extra taxation applies to supplementary income derived following the deregulation of the natural gas price. This tax is payable by companies that extract and sell natural gas from Romania (including offshore).

The tax is 60% of the additional income derived as a result of the deregulation of the natural gas price, after deduction of royalties related to this income and investments made in the upstream sector. Deduction of investment in the upstream sector should not exceed 30% of the additional income.

Additional tax due = 0.60 * (additional income – royalty * additional income - investment in upstream sector)

Special tax on oil exploitation

This tax is calculated as 0.5% of the turnover registered by companies exploiting crude oil. The income to which income tax applies is determined based on a certain formula.

Part IV

Other aspects

// Companies in the oil and gas industry which are parties to a farm-in agreement usually set up a joint venture association with specific tax regulations. //



Farm-ins and farm-outs

A “farm-in” is the industry term commonly used to describe the investment process by which a company (“farmee”) purchases an interest in an exploration licence. The consideration paid for a farm-in investment often takes the form of a commitment by the farmee to meet future exploration or development costs that otherwise would be met by the owner (“farmor”), and may also involve reimbursement to the farmor of a portion of the capital expenditure incurred to date.

Companies in the oil and gas industry which are parties to a farm-in agreement usually set up a joint venture association with specific tax regulations.

From a CIT perspective, the revenue and expenses of the joint venture are attributed to each member according to its participation quota in the newly created association.

From a VAT perspective, a joint venture does not represent a taxable person. The VAT rights and obligations of the association should be carried out by one of the members. Different VAT treatment may be applied depending whether the allocation of revenue and expenses takes into account or not the participation interest quota.

Currency

Taxes must be declared and paid in Romanian national currency (RON). As a general rule, accounting registrations must also be recorded in lei. For operations carried out in a foreign currency, entries should be made both in lei and the foreign currency.

Authorization of petroleum operations

Romanian legislation provides specific rules for granting petroleum concessions and developing petroleum activities.

Non-resident companies which are granted the right to perform petroleum operations are likely to be required to set up a presence in Romania (subsidiary or branch). Even where this is not necessary, the operations themselves could trigger the need to register a taxable presence in Romania. Several options are available, such as setting up a subsidiary, a branch or a permanent establishment.

Environmental fund

Companies which release pollutant emissions are subject to a specific tax payable to the environmental fund which depends on the type of pollutant substance produced.



APPENDIX

Comparison of branch versus subsidiary

Subsidiary	PE / Branch
Registration	
Must submit a set of documents to the Trade Registry	PE – Must submit only the fiscal registration forms to the tax authorities Branch – Trade Registry registration is also required
Calculation of taxable profit	
Profit tax liabilities must be declared on a quarterly basis and an annual profit tax return completed. After the first year, a system based on advanced quarterly payments can be applied. Fiscal losses can be carried forward to offset future fiscal profits over the next seven consecutive years. A legal reserve fund must be set up, representing at least 5% of the company's taxable profit until this fund reaches a maximum of 20% of the share capital.	The profits of a PE should be calculated using the arm's length principle vis-à-vis its relations with its parent company. After the first year, a system based on advanced quarterly payments can be applied. Similar. The requirement to set up the legal reserve is not applicable to branches / PEs.
Distribution of dividends by the subsidiary/branch/PE to its shareholder	
A 16% tax rate is generally applied to dividends paid by a Romanian subsidiary to another legal entity. This can be reduced to nil under relevant EU directives. More favourable tax rates may be applicable depending on the specific provisions of Double Tax Treaties.	Payments made by branches / PEs to their head office are unlikely to be subject to Romanian withholding tax. To determine the withholding tax treatment of payments made to the Romanian PE of a company resident in a third country, the provisions of the DTT concluded between the head-office and that third country are applied
Loan-related payments made by the subsidiary/PE to its parent	
For payments made by a subsidiary to its parent, interest deductibility limits and thin capitalization rules are applicable.	Similar
Transfer pricing	
Transfer pricing tests are generally set based on 25% common ownership. Taxpayers which carry out transactions with affiliated parties are required to prepare a transfer pricing file, which must be presented to the tax authorities on request.	There are no differences between the transfer pricing regulations applicable to a subsidiary and to a branch / PE. The branch / PE and head-office are seen as different entities and transfer pricing rules must be applied. When calculating the profit attributable to the PE, the OECD arm's length principle must be applied. Similar.
VAT and other indirect taxes	
Similar treatment – please refer to Part II.	Similar treatment – please refer to Part II.

ABBREVIATIONS

CIT – Corporate income tax

EU – European Union

DTT – Double Tax Treaty

OECD – Organisation for Economic Co-operation and Development

NRAE – National Regulatory Authority for Energy

VAT – Value Added Tax

WHT – Withholding tax

PE – Permanent Establishment



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