Employment, Tax and Procurement legal and contracting aspects related to Outsourcing in Romania

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An outsourcing transaction, by which a business activity undertaken by a company is transferred to an external provider, usually has as driving the financial component. Although outsourcing transactions can bring major financial benefits to the involved companies, in order for the outsourcing to turn up successful, the transaction has to be closely analysed from all related perspectives, and not just the financial one.

Employment

The employment aspects associated to an outsourcing transaction can be vital for the success of the transaction. When outsourcing involves the transfer of an undertaking, of a business or part of an undertaking or business, the companies concluding the outsourcing transaction have to ensure that the employees’ rights are correctly safeguarded. In Romania, the employees’ transfer related rights are governed mainly by Law no. 53/2003 regarding the Labour Code and Law no. 67/2006 regarding the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (“Law 67/2006”) which transposed Council Directive 2001/23/EC on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (“Acquired Rights Directive”). The outsourcing transaction may be subject to the provisions of Law 67/2006 in case it involves a transfer in the sense provided by this law (which is less comprehensive than the definition of transfer under the Acquired Rights Directive), namely the change of ownership over an undertaking, business or parts thereof with the purpose of carrying on of the central or ancillary activity, regardless on whether or not the scope is to obtain profit.

The main effect when regarding the outsourced activity as a transfer under Law 67/2006 is that all rights and obligations of the transferor (the company contracting-out the activity) deriving from the employment contracts and collective bargaining agreements existing on the date of the transfer, shall be fully transferred to the transferee (the external provider), namely the transferee takes over both the outsourced activity and the transferor’s employees who perform this activity. Considering the importance and potential consequences of this effect for the parties to the transaction, it is vital to determine whether the outsourced activity represents or not a transfer under Law 67/2006.

The disputes in this respect usually arise when trying to determine whether or not the outsourced activities are identical with the activities performed by the outsourcing company prior to the transaction. According to the case law of the Court of Justice of the European Union (“CJEU”), Case C-392/92 Schmidt, which are mandatory in Romania as part of the Community acquis, the question (in case of outsourced activities) is whether the business/activity in question retains its identity, the retention of identity being indicated, according to CJEU, inter alia by the actual continuation or resumption by the employer of the same or similar activities. In Case C-392/92 Schmidt, CJEU concluded that the transfer under the Acquired Rights Directive is to be interpreted as covering a situation in which an undertaking entrusts by contract to another undertaking the responsibility for carrying out cleaning operations which it previously performed itself, even though, prior to the transfer, such work was carried out by a single employee.

Given the European case law, it cannot be excluded that outsourcing, depending on the actual circumstances, be deemed as a transfer of undertaking, business or parts thereof under the Romanian law. Should outsourcing be deemed in such way, the employees of the company outsourcing the activities in which the respective employees are involved shall most likely benefit from protection according to Law 67/2006, although it is debatable whether in case of cross border transactions, the employees would be willing to relocate so as to solely benefit from protection. In case Law 67/2006 applies to the outsourcing transaction, except for the protection granted by the automatic transfer of the employees to the external provider, certain protection measures, such as the following, shall also apply: employees cannot be dismissed because of the transfer neither by the outsourcing company nor the external provider; the companies part to the outsourcing transaction are compelled to inform and consult, prior to the transfer, the employees’ representatives as regards the legal, economical and social implications derived from the change of ownership; as a rule, the external provider has to observe the provisions of any collective bargaining agreement applicable on the date of the transfer, until its termination or expiry; the companies part to the outsourcing transaction are compelled to inform the employees’ representatives or their own employees as regards the date of the transfer and the proposed date of the transfer, the reasons of the transfer, the foreseeable measures as regards the employees, the employment and work conditions.

Ignoring the principles on the safeguard of employees in the event of a transfer of an undertaking, of a business or part of an undertaking or business in case such principles apply to the outsourcing transaction could have costly consequences both for the
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Tax

The tax implications of outsourcing transactions usually vary, as each transaction has its own specificity. The most common tax implications which should be considered when outsourcing refer to: tax on transaction, value added tax ("VAT"), transfer pricing, taxable presence. The list is not exhaustive and additional tax implications can arise especially in case of cross-border transactions which potentially involve the application of several tax regimes. Such additional tax implications refer, inter alia, to: withholding tax and potential tax incentives.

Tax on transaction

In Romania, in principle, no tax shall apply on the outsourcing transaction itself. In the situation where a transaction implies the transfer of assets, this might give rise to taxation, depending on the nature of the assets. Usually, taxation arises in connection with the transfer of real estate property located in Romania and of participation titles to Romanian companies having real estate properties as at least 50% of the tangible assets. However, usually, if the transaction implies solely the transfer of other tangible assets, which is more likely in case of outsourcing transactions, the transaction itself shall be tax free.

VAT

The implications on VAT reside in the fact that when the outsourcing transaction implies the transfer of assets, as a rule, such transaction shall be subject to VAT, according to the Romanian legislation (Law no. 571/2003 regarding the Fiscal Code, "Fiscal Code"). Nevertheless, in case the person receiving the assets is a taxable person, such transfer might not be subject to VAT.

From a cost savings perspective, the outsourcing company shall have to carefully consider the VAT to be charged by the external provider for the supply of the services. This implies that the decision to outsource has to be based on the actual cost incurred by the outsourcing company (price including VAT) even if, normally, the VAT incurred by a company in the course of its business may be recovered from the relevant tax authorities, provided that the company performs transactions which give rise to VAT deduction right.

Transfer pricing

Outsourcing is a common practice within group of companies, as group companies usually wish to pass on the benefit and burden of certain services within the group. Transfer pricing implications may arise in case of intra-group outsourcing transactions depending on the degree of affiliation between the group companies. In Romania, a legal entity is considered affiliated with another legal entity if: one of the legal entities holds, directly or indirectly, including the holdings of affiliated entities, minimum 25% of the value/number of the participation titles or voting rights in the other legal entity or if it controls the legal entity or a third legal entity holds, directly or indirectly, including the holdings of affiliated entities, minimum 25% of the value/number of the participation titles or voting rights both in the first and in the second legal entity.

In case the outsourcing transaction is concluded between affiliated companies, then the parties are required to observe within the transaction between them the arm's length principle, namely the transaction price has to reflect the market price, by using an appropriate transfer pricing method. The Fiscal Code includes specific provisions as regards transfer pricing, which are compliant with and supplemented by the transfer pricing guidelines issued by the Organisation for Economic Co-operation and Development. In Romania, in case affiliated companies do not observe the transfer pricing regulations, the Romanian tax authorities are entitled to adjust the income or the expense of any of the affiliated companies in order to reflect the market price of the goods/services delivered/provided during such transaction.

The transfer pricing implications are also important in case of cross-border outsourcing transactions where one affiliated company wishes to pay the costs with the services outsourced by all group companies. In such case, it is important to ensure that such costs are charged to the group companies on an arm's length principle. Affiliated companies which are part to such transactions may be requested to prove the determination of the price by presenting the relevant transfer pricing file. Therefore, the affiliated companies usually prepare transfer pricing files to ensure that the arm's length principle is observed prior to effectively performing the transactions.

Taxable presence

In some cross border outsourcing transactions, there is a risk that the outsourcing of services gives rise to a permanent establishment either of the outsourcing company in the state where the external provider is resident or of the external provider in the state where the outsourcing company is resident, in case the external provider undertakes the outsourced activity in the latter state. The broad sense of the concept of permanent establishment as provided by the Fiscal Code is that of a place through which the business of a non-resident is wholly or partially carried on, either directly, or through a dependent agent. Although in general the taxable presence of an outsourcing company within the state where the services are outsourced is unlikely when the services provider acts as an independent agent (which it normally does), attention should be paid for the outsourcing transaction to be carefully structured. For instance, in Romania, a non-resident shall be deemed as having a permanent establishment, as regards the activities which a person, other than an agent of an independent status, carries on in the name of the non-resident, if the person acts in Romania on behalf of the non-resident and if one of the following conditions is met: the person is authorised to and maintains in Romania a stock of goods or merchandise from which the person delivers goods or merchandise in the name of the non-resident. Nonetheless, double taxation treaties should be considered, as they include specific provisions, rules and exemptions, as regards taxable presence.

Public Procurement
Outsourcing is a common practice in the public procurement field. In Romania, public bodies can outsource services either by contracting-out the respective services or by entering into public-private partnerships. As a rule, public bodies are compelled to observe mandatory provisions when outsourcing services, in particular the ones included in Government Emergency Ordinance No. 34/2006 regarding the award of public procurement contracts, public works concession contracts and services concession contracts (“GEO 34/2006”). Under the Romanian law, except public bodies, there are also several other entities which are subject to the public procurement legislation. GEO 34/2006 refers to them as contracting authorities, the concept including public bodies, other organisations having legal personality and established for the specific purpose of meeting needs of general interest, not having an industrial or commercial character, that are financed, subordinated or under supervision of a public body, associations of the above, public undertakings performing relevant activities in the public utilities sectors (respectively: water, energy, transport and postal services) or any other entities that conduct one or more of the activities relevant in the public utilities sectors, based on a special or exclusive right, given by a competent authority, when it awards a public procurement contract or it concludes a framework agreement meant for conducting the respective activities.

Occasionally, the outsourcing of services can be subject to the Romanian public procurement legislation even if the legal entity outsourcing the services is not a contracting authority according to GEO 34/2006. This may occur in case the following cumulative requirements are met:

- the contract by which the services are outsourced is financed/subsidised directly, in a proportion of more than 50%, by a contracting authority,
- the estimated value of the respective contract is equal or higher than the equivalent in RON of EUR 193,000.

Also, the beneficiaries of structural funds may be requested to observe the rules provided by GEO 34/2006. Exceptionally, a contracting authority is entitled to outsource services directly, namely without applying the Romanian public procurement legislation, provided that the value of the acquisition does not exceed the equivalent in RON of EUR 15,000 for each acquisition of services.

In Romania, the following procedures may be undertaken for the outsourcing of services by a contracting authority: open bid, restricted bid, competitive dialogue, negotiation, request for tenders and design contest. The general rule is that the contracting authority has to apply the open bid or restricted bid procedures for outsourcing services. The other awarding procedures may be applied only under special circumstances.

Any operator participating to an award procedure is entitled to include in its technical proposal the possibility of contracting-out a part of the outsourced services; however, this shall not lead to the mitigation of its responsibility as regards the manner of fulfilling the future contract. Special attention must be paid in case the winning operator wishes to outsource part or whole of the already outsourced services, during the performance of the awarded contract, in the situation where such outsourcing has not been contemplated during the award procedure. It is likely that this second outsourcing be deemed as an amendment of the initially awarded contract, which might infringe the Romanian public procurement legislation. The Romanian public procurement legislation does not expressly provide the situations that are considered infringements, but the European case law is observed in this respect. The Court of Justice of the European Union has stated in Case C-454/06 pressetext Nachrichtenagentur that amendments to the provisions of a public contract during the currency of the contract constitute a new award of the contract […] when they are materially different in character from the original contract and, therefore, such as to demonstrate the intention of the parties to renegotiate the essential terms of that contract. In practice, the Romanian public procurement supervisory body stated that the following should be considered when sub-contracting-out part of the outsourced services: whether the contracting authority accepts such sub-contracting out, whether the sub-contracting is beneficial for the contracting authority, the sub-contract has to include the same terms as the initial outsourcing contract, the sub-contracting should not lead to an amendment of the initial offer, the sub-contract should not introduce conditions which, had they been part of the initial award procedure, would have allowed for the admission of tenderers other than those initially admitted or would have allowed for the acceptance of a tender other than the one initially accepted, the sub-contract should not extend the scope of the initially outsourcing contract considerably to encompass services not initially covered, the sub-contract should not change the economic balance of the initially outsourcing contract in favour of the winning tenderer in a manner which was not provided for in the terms of the initial contract. As regards the sub-contracting of the whole outsourced services, the Court of Justice of the European Union’s judgement in Case C-454/06 has to be observed. According to such judgment, the substitution of a new contractual partner for the one to which the contracting authority has initially awarded the contract must be regarded as constituting a change to one of the essential terms of the public contract in question, unless that substitution was provided for in the terms of the initial contract.

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