

# LEGAL, ACCOUNTING AND FISCAL ASPECTS REGARDING DIVIDENDS

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**Abstract:**

*The purpose of the paper is a synthesis of the legal, accounting and fiscal aspects regarding dividends from two perspectives: 1) economic entities that allot dividends; 2) economic entities that benefit from dividends. The paper highlights the way in which the accounting and fiscal treatment of dividends is influenced by the date of the approval of annual accounts, the date of the dividend payment, by the date of the declaration and dividend tax payment. The sources of information used to elaborate the paper are mainly the most recent legal provisions.*

**Key words:** dividends, tax, fiscal, accountancy

**JEL classification:** M41 - Accounting

According to the provisions of article 67 of law no 31/1990 on Trading Companies, dividends are the part of the profit that is due to each of the shareholders.

As regards the distribution of dividends, the text of the law sets the following regulations:

- Dividends shall be paid to the associates in proportion with their participation quota to the paid-up capital stock, unless the constitutive act provides otherwise;
- Dividends can be distributed only out of real profits;
- Dividends paid with the infringement of the provisions shall be reimbursed, provided the company proves that the associates were or should have been familiar to the irregularities in their distribution;
- The right to suit for the reimbursement of the dividends paid with the infringement of the legal provisions is limited to 3 years since the day of their distribution.
- Article 73 provides that the managers are jointly liable towards the company for the actual existence of the paid dividends;
- In the case of joint stock companies, article 123 provides that the share holders entitled to cash or to exercise dividends are those whose names are entered into the company's documents or into those provided by the independent private register of the shareholders, as compared to the certain date;
- The certain date should be subsequent to the publication of the call of the general meeting and will not exceed 60 days before the day established for the first call of the general meeting.

Law no 31/1990 provides at art. 123 that The dividends shall be paid during the period fixed by the general meeting of the associates or, if necessary, established by special laws, but will not exceed 6 months from the day of the approval of annual accounts for the financial period ended. If the time limit is not met the company will pay damages for the delay, at legal interest level, whether by the memorandum of the association or by the decision of general meeting of shareholders which approved the annual accounts for the financial period ended if a higher interest rate was not set.

Article 272 of the Law on Trading Companies provides that it is to be sentenced to prison the founder, manager, director, executive director or the legal representative of the company who cashes or pays dividends, in any form, out of false profits or which

could not be distributed, due to the lack of a balance sheet or contrary to those resulting there from.

The Fiscal Code, in article 7 (12), equates the concept of dividend with a distribution in money or in kind made by a legal person to a participant in the legal person as a consequence of the ownership of participation titles in such legal person, except for the following:

- a distribution of additional participation titles that do not modify the percentage of ownership of the participation titles of any participant in the legal person;
- a distribution in money or in kind made in connection with the redemption of participation titles in the legal person, other than a redemption that is part of a plan of redemption that does not modify the percentage of ownership of the participation titles of any participant in the legal person;
- a distribution in money or in kind made in connection with the liquidation of a legal person;
- a distribution in money or in kind made on the occasion of a reduction of social capital actually constituted by participants.

According to the Fiscal Code the goods and the services provided for the personal purpose of a shareholder or of an associate of the legal person are assimilated as dividends.

Further on I will emphasize the particularities of the dividend accounting and taxation in the next two situations: 1) trading companies that allot dividends; 2) trading companies that benefit from dividends.

In the accountancy of trading companies that allot dividends, the provisions of OMPF 1752/2005, section 169 strengthened by section 222, according to which the dividends distributed to the shareholders proposed or declared after the balance sheet date should not be accepted as debts at the balance sheet date, are applied.

As a consequence to these regulations, the book entry of dividends is done after the general meeting of the shareholders or associates that have approved the allotment of profit.

At a financial level, the provisions of the Fiscal Code will be applied. According to article 36 a legal Romanian person that pays a dividend to a Romanian legal person is required to withhold, declare and pay tax on dividends. The tax on dividends is to be determined by applying a tax rate to the gross dividend.

The tax rate is:

a) 10% if the beneficiary of the dividends is a Romanian legal person (art. 36 of the Fiscal Code) and for the dividends paid by an enterprise, which is a Romanian legal person to a legal person resident of a European Union member state and of one of the member states of the European Free Trade Association, i.e. Iceland, Liechtenstein, the Kingdom of Norway, or to a permanent headquarters of an enterprise in a European Union member or in a state in the European Free Trade Association, i.e. Iceland, Liechtenstein, the Kingdom of Norway, situated in another European Union or European Free Trade Association member state. (art. 116 of the Fiscal Code);

b) 16%, if the beneficiary is a natural person (art. 67 of the Fiscal Code);

In the case of non-resident persons, the tax rate cannot exceed the one established by the conventions for the avoidance of double taxation.

The tax on dividends is to be withheld, declared and paid to the state budget on or before the 20<sup>th</sup> of the month that follows the month in which the dividend is paid. When allocated dividends are not paid by the end of the year in which the annual financial reports have been approved, the tax on dividends is to be paid by December 31<sup>st</sup> of that year.

The dividends paid by a Romanian legal person to another Romanian legal person are tax deductible, if the beneficiary of the dividends owns minimum 15%,

between 01.01.2007-31<sup>st</sup> December, 2008, and 10%, since 2009, of the participation titles on the date when the dividend is paid, for a period of two years ending on the date when the dividend is paid. (art. 36 paragraph 4 of the Fiscal Code).

In accordance with the provisions of article 117 letter h) in the Fiscal Code, are exempt from tax:

- dividends paid by a Romanian legal person to a legal person in a member state of the European Community or in one of the states of the European Free Trade Association, i.e. Iceland, Liechtenstein, the Kingdom of Norway;
- dividends paid by a Romanian legal person or to a permanent headquarters of an enterprise in a member state of the European Union or in one of the states of the European Free Trade Association, i.e. Iceland, Liechtenstein, the Kingdom of Norway situated in another member state of the European Union or of the European Free Trade Association.

This exemption from the tax is applied if the beneficiary of the dividends owns minimum 15% of the participation titles of the Romanian legal person enterprise for an uninterrupted period of at least 2 years ending on the date when the dividend is paid. The condition of minimum holding is of 10% starting with 2009.

Starting with 2009, according to GEO 200/2008, are exempt from taxes:

1) Reinvested dividends, with the purpose of preserving and increasing jobs for the business development of Romanian legal persons that distribute dividends, in accordance with their business activity entered into the National Office of Trade Register;

2) Dividends invested in the joint stock of another Romanian legal person, with the purpose of creating new jobs, for the business development, in accordance with their business activity entered into the National Office of Trade Register.

The tax on the dividends distributed to Romanian natural and legal persons is to be declared in Statement 100 regarding the payment obligations on the overall budget, at “Tax on dividends”. The tax on the dividends distributed to non-residential Romanian natural and legal persons is to be declared in Statement 100, at “tax on income earned in Romania by non-residents”. For the dividends distributed to legal Romanian persons Declaration 205 tax is also to be submitted – Statement regarding withholding tax for withholding income at the source, on income beneficiaries, with submission deadline on 30<sup>th</sup> June current year for the previous year.

In the accounting of the beneficiary trading companies, the dividends to collect are included in earned income. In accordance with provisions of OMPF 1752/2005, section 216, dividend income is admitted when the shareholder has the right to collect it. Therefore, in the accounting of the beneficiary trading company, the entry of income dividends is done after the general meeting of the shareholders or associates the have approved on profit distribution.

From a fiscal point of view, the provisions of Title II of the Fiscal Code, regarding the profit tax are to be applied. Article 20 of the Fiscal Code provides for the case in which these incomes are not taxable in computing taxable profit.

The synthesis of the aspects related to tax exemption for dividend income is shown in table number 1:

Table number 1- The synthesis of the regulations regarding tax exemption for dividend income

Tax exempted	Condition	The minimum participation rate to the joint stock	Reference date

Dividends received from a Romanian legal person;			
Dividends received from a Romanian legal person, parent company, from one of its subsidiaries in a EU member state;	If the Romanian legal person meets, on cumulative basis, the following requirements:		
	1. pays profit tax, without possibility of an option or exemption;		
	2. holds a certain percentage of the participation titles of the dividend payer situated in one of the EU member states	15 %	After adhesion date
		10%	Starting with 2009
3. holds the minimum participation, as provided in section 2, for an uninterrupted period of at least 2 years, at the date of dividend income registration			
Dividends received by the Romanian legal person by the means of its permanent headquarters situated in a EU member state, if the Romanian legal person meets, on cumulative basis, the requirements mentioned above (1-3)			
Dividends received by the permanent headquarters in Romania of foreign legal persons from other EU member states, parent companies, that are distributed by their subsidiaries situated in EU member states.	If the foreign legal person meets, on cumulative basis, the following requirements:		
	1. has one of the organization forms stipulated in the Fiscal Code, article 20 <sup>1</sup> paragraph (4);		
	2. in conformity with the tax legislation of the member state, it is considered to be resident of that member state and, on the basis of an agreement with a third state regarding the avoidance of double taxation, the fiscal headquarters is considered not to be outside the borders of European Union;		
	3. pays, without possibility of an option or exemption, profit tax or a similar tax, in conformity with the tax legislation of a member state;		
	4. holds a certain percentage minimum 15% of the joint stock of the subsidiary in a EU member state, i.e. a minimum participation of 10%, starting with 1 <sup>st</sup> January 2009;	15 %	After adhesion date
10%		Starting with 2009	
5. at the date of dividend income registration by the permanent headquarters in Romania, the foreign legal person holds the minimum participation rate provided in section 4, for an uninterrupted period of at least 2 years.			

Case study: A trading company 'A' has the following structure of the shareholding:

- a Romanian legal person 'B', the participation rate to the joint stock is 80%, held for an period of more than 2 years;
- a legal person 'C', resident in France, the participation rate to the joint stock is 15%, held for less than 2 years;
- a Romanian natural person 'D', holding 5% of the joint stock;

The year 2008 ended with a clear profit of 100.000 lei that the General Meeting of the Shareholders decides to distribute as follows: 5% for legal reserves; 10% for other reserves; 85 % dividends.

On 31<sup>st</sup> December 2008, the accounting of trading company 'A' records the following distribution of profits:

129 'Distribution of profit'	=	%	<u>100.000 lei</u>
		1061 'Legal reserves'	5.000 lei
		1068 'Other reserves'	10.000 lei
		1171 'The reported result representing undistributed profit or uncovered loss'	85.000 lei

At the beginning of 2009, the profit and loss account is closed:

121	=	129	100.000 lei
'Profit or loss'		'Distribution of profit'	

In March 2009 after the approval of annual accounts that are owed to share holders are recorded:

1171 'Reported result representing the undistributed profit or the uncovered loss'	=	457	<u>85.000 lei</u>
		'Dividends to pay'	

In case that the dividends are paid in April 2009, the tax on dividends is calculated and withheld this month. The taxed dividend situation is the following:

Shareholder	C%	Gross dividend - lei-	Tax rate	Tax -lei-	Dividends to pay -lei-
B	80%	68.000	-	-	68.000
C	15%	12.750	10%	1.275	11.475
D	5%	4.250	16%	680	3.570
	100%	85.000		1.955	83.045

The tax on dividends and debt payment to shareholders are recorded:

457 'Dividends to pay'	=	%	<u>85.000 lei</u>
		446 'Other taxes, fees and assimilated payments'	1.955 lei
		5121 'Bank accounts in lei'	83.045 lei

The tax on dividends will be paid until 25<sup>th</sup> May, 2009:

446 'Other taxes, fees and assimilated payments'	=	5121 'Bank accounts in lei'	1.955 lei
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In March 2009, the accountancy of trading company 'B' registers the right to the dividends:

461 'Various debtors'	=	761 'income from financial fixed assets'	68.000 lei
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Dividends are collected in April 2009:

5121 'Bank accounts in lei'	=	461 'Various debtors'	68.000 lei
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The beneficiary will fill in the Fiscal Ledger quarterly, to calculate the profit tax, subtracting the tax exempted dividends from the taxable profit In Statement 101 – Statement regarding profit tax that will be drawn for 2009, the dividend beneficiary will report the received dividends or the dividends that will be received as taxable income.

Conclusion: ● The company that distributes dividends observes the provisions in the Fiscal Code regarding the tax on dividends, while the company that benefits from dividends observes the provisions in the Fiscal Code, regarding the profit tax. ● In the case of the company that distributes dividends, the fiscal and accounting treatment of the dividends has the following characteristics in the following three moments: a) the date when the annual accounts are approved in the general meeting of the shareholders; b) the data when the dividends are paid; c) the date when the tax on dividends is declared and paid. ● The date when the annual accounts are approved affects both the accounting of the company that distributes the dividends and of the company that receives the dividends. At this date, the company that distributes the dividends records the debts to the shareholders/ associates, while the beneficiary company records the right to collect the dividends. ● When the dividends are paid the tax on the dividends is calculated, withheld and booked. ● the payment and declaration of the tax on dividends shall be done until the 25<sup>th</sup> day of the month that follows the month when the dividends were paid.

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