



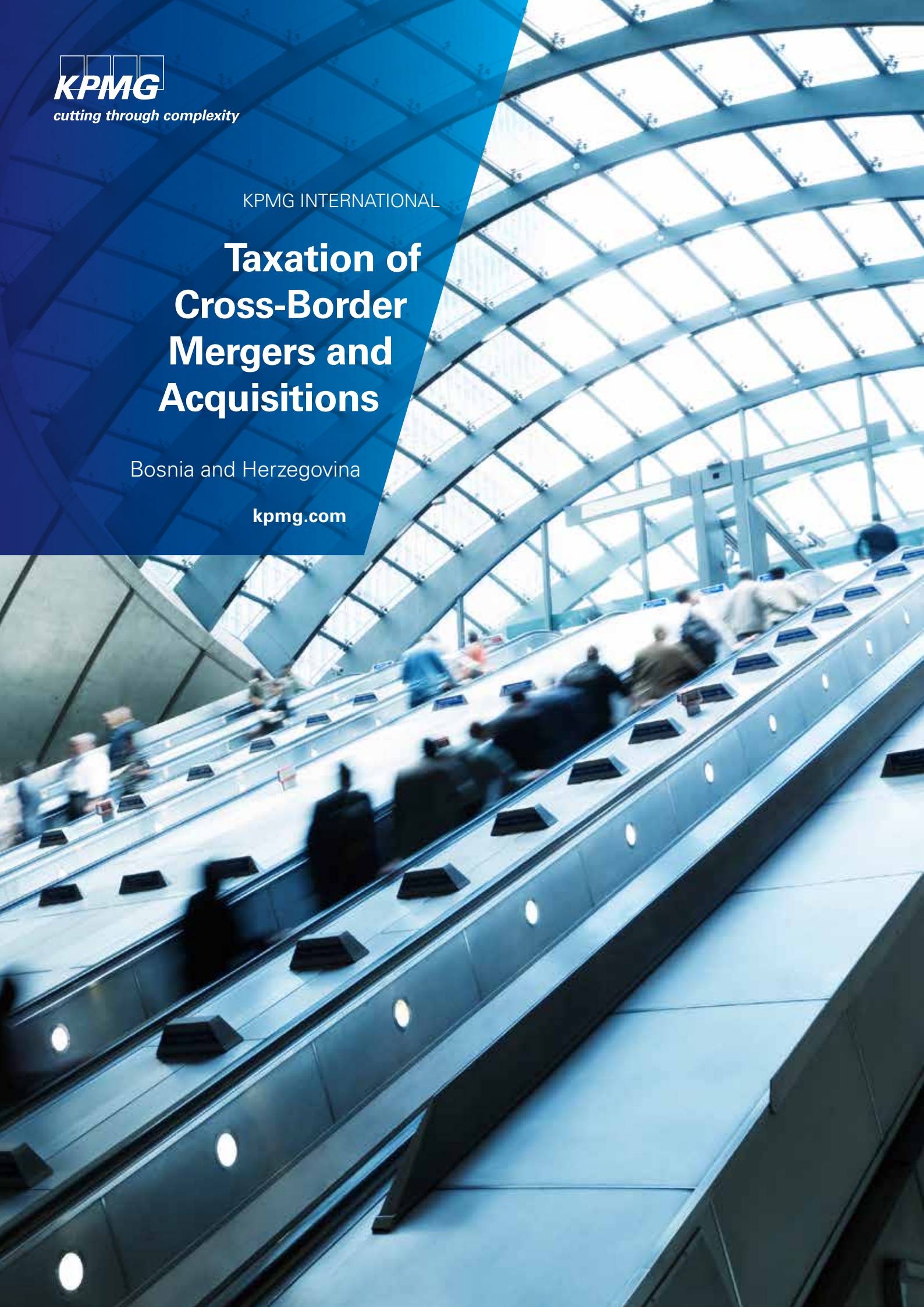
cutting through complexity

KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Bosnia and Herzegovina

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Bosnia and Herzegovina

Introduction

Bosnia and Herzegovina (BiH) is administratively divided into two major entities: the Federation of Bosnia and Herzegovina (FBiH) and the Republic of Srpska (RS). Indirect taxes are regulated nationally at the level of BiH, and direct taxes are regulated at the level of entities. This results in a complex tax environment with different rules and requirements in each entity.

Despite the complex tax environment, BiH generally has been an attractive market for foreign investors, resulting in a number of successful mergers and acquisition (M&A) projects.

In recent years, however, M&A activity has decreased, due to the worsening global financial climate in part but also due to a lack of official guidance and practice regarding BiH's complex taxation system.

This chapter provides general information on M&A provisions in BiH that have been in place since 2007 and 2008 in RS and FBiH, respectively.

Despite the number of mergers and acquisitions that took place in BiH in recent years, the BiH tax system is still relatively immature. A number of structuring options available in other jurisdictions are not used in BiH, so KPMG in Bosnia and Herzegovina cannot comment on them.

Recent developments

There have been no significant changes to the Corporate Profit Tax (CPT) in RS or FBiH since new legislation was introduced in 2007 and 2008, respectively.

The main provisions of CPT Law in both the FBiH and the RS are summarized in the following paragraphs.

Mergers and acquisitions

Federation of Bosnia and Herzegovina

Based on the FBiH CPT Law, where there is a continuance in taxation (i.e. the successor continues to be a taxpayer), a merger is CPT-neutral. Continuance in taxation is deemed to exist where assets and liabilities are transferred from predecessor to successor at their net book value.

Rights and liabilities of a predecessor are transferred to a successor. The predecessor is obliged to submit its financial statements and final CPT return up to the merger date.

Republic of Srpska

Based on the RS CPT Law, where there is a continuance in taxation (i.e. the successor continues to be a taxpayer), a merger is CPT-neutral. Continuance in taxation is deemed to exist where assets and liabilities are transferred from predecessor to successor at their net book value.

Rights and liabilities of a predecessor are transferred to a successor. The predecessor is obliged to submit its financial statements and final CPT return up to the merger date.

Incentives

Federation of Bosnia and Herzegovina

Tax incentives relevant for M&A transactions in FBiH include the following:

- 100 percent CPT holiday in the year in which a taxpayer realizes more than 30 percent of total annual revenue through export
- 100 percent CPT holiday for a five-year period where the taxpayer invests 20 million Bosnian convertible marks (BAM; approximately 10 million Euros – EUR) in production facilities in the FBiH. BAM4 million (approximately EUR2 million) must be invested in the first year
- 100 percent CPT holiday in a year in which more than 50 percent of the taxpayer's employees are people with disabilities (but only for a year in which more than 50 percent of the total number of employees are disabled persons).

Republic of Srpska

Tax incentives relevant for M&A transaction in the RS include:

- a reduction in the CPT base up to the amount corresponding to the value of the investment into property, plant and equipment (PPE) that are necessary for the purposes of conducting registered business manufacturing activities, provided the PPE is not sold within 3 years from the day that the PPE is put into use.
- a reduction in the CPT base up to the amount of personal income tax and social security contributions paid for new workers, where a taxpayer employs 30 new workers for an indefinite term within one tax period; where the taxpayer does not keep all 30 employees for a three-year period, it must repay the amount of tax and social security contributions by which it reduced its CPT base in the prior periods.

Withholding tax

Federation of Bosnia and Herzegovina

Withholding tax (WHT) applies to certain payments made to non-resident legal entities. These payments include dividends, specified interest payments and payments for intellectual property rights, market research, tax advisory, business advisory and audit services, as well as all other services performed by non-residents within the territory of FBiH.

The standard WHT rate is 10 percent, while a rate of 5 percent applies to dividend payments.

The WHT rate may be decreased or eliminated pursuant to an effective tax treaty.

Republic of Srpska

WHT applies to certain payments made to non-resident legal entities, including specified interest payments and payments for intellectual property rights, market research, tax advisory, business advisory and audit services.

WHT is generally payable on services that are rendered by foreign legal entities within the territory of the RS.

The WHT rate is 10 percent.

No WHT is levied on dividends paid to foreign companies holding more than 10 percent of the shares of an entity registered in the RS.

The WHT rate may be decreased or eliminated pursuant to an effective tax treaty.

Asset purchase or share purchase

Purchase of assets

Federation of Bosnia and Herzegovina

In accordance with the CPT Law in FBiH, capital gains determined in the balance sheet are added to the CPT base. Capital gains are defined as all amounts that directly increase accumulated and current profits in the balance sheet, disclosed in line with International Accounting Standards (IAS) and/or International Financial Reporting Standards (IFRS).

The historical tax liabilities generally remain with the company; that is, a taxpayer undergoing a change of status

is obliged to submit its financial statements and CPT returns with a closing date a day before the date of the merger.

Republic of Srpska

In accordance with RS CPT Law, capital gains/losses increase/decrease the tax base. Capital gains are defined as an increase in transaction value of assets from the moment of their purchase until the moment of their disposal.

Goodwill

Federation of Bosnia and Herzegovina

The tax treatment of goodwill follows the IFRS treatment; goodwill is subject to the impairment test and not to annual amortization.

Republic of Srpska

In accordance with RS CPT Law, internally created and verified goodwill is not subject to annual amortization. Where the goodwill is acquired externally and the purchase price is known, it can be amortized over a period of 15 years.

Depreciation

Federation of Bosnia and Herzegovina

Depreciation of assets is generally recognized for tax purposes up to the amounts prescribed by the CPT Law. Depreciation charges not recognized in previous years can be deducted from the tax base in subsequent years.

Republic of Srpska

Depreciation of assets is generally recognized for tax purposes up to the amounts prescribed by the CPT Law.

Value added tax

Value added tax (VAT) in BiH is levied at the state level and generally complies with the European Union VAT Directive.

The standard VAT rate is 17 percent. Exports of goods are VAT-exempt (with the right to recover input VAT; i.e. taxable at 0 percent).

Generally, the transfer of a part of a taxpayer's property is considered as a sale of goods for consideration, subject to

VAT, where input VAT was fully or partially deductible when the property was purchased, manufactured or otherwise acquired.

The transfer of a business as a going concern, however, is outside the scope of VAT, provided certain conditions are met. The effect of the transfer must be to put the new owner in possession of an operating business.

Transfer taxes

Transfers of land and buildings may be subject to real estate transfer tax, which is levied at the level of FBiH's 10 cantons.

Real estate transfer tax in the RS was abolished as of 1 January 2012, and a property tax was introduced. The property tax rate varies from 0.05 percent to 0.50 percent of the total asset value.

Purchase of shares

The purchase of a target company's shares does not result in an increase in the base cost of that company's underlying assets; there is no deduction for the difference between underlying net asset values and consideration.

Tax losses

Tax losses are not transferred on an asset acquisition. They generally remain with the company (applicable to entities in both FBiH and RS).

In principle, in an acquisition of shares, carried forward tax losses previously generated by a target company remain with a company.

In both FBiH and RS, tax losses incurred in one tax year can be carried forward and deducted from a tax base for five consecutive years, after which the right to deduction expires.

Tax losses cannot be carried back.

Crystallization of tax charges

For both FBiH and RS, the statute of limitations for tax liabilities is generally 5 years, unless fraud is suspected.

It is not unusual for the purchaser to obtain an appropriate indemnity from the seller for the statute of limitations.

Pre-sale dividend

Relevant legislation is not explicit in prescribing whether or not advance dividends are possible, and the tax authorities of FBiH and RS have not issued an guidance on their tax treatment, to the knowledge of KPMG in BiH. In practice, advance dividends are not common.

There are no explicit limitations to payment of advance dividends, except that they are subject to final assessment of profits at year-end.

In other words, advance dividends should be recorded as receivables until the year-end assessment of profits, after which they are either recorded as distributed profits. In the case of loss, the recipient of advance dividends is obliged to refund them or keep them as advance dividends for future periods.

Choice of acquisition vehicle

Local holding company

Dividends received in both entities are not taxable, but capital gains on sales of shares are subject to CPT.

Foreign parent company

Federation of Bosnia and Herzegovina

Traditionally, the most commonly used acquisition vehicle has been a foreign parent company, due to the incentives available to foreign investors in the FBiH.

However, WHT applies to dividends, interest and certain other payments paid to non-residents by an FBiH resident, subject to tax treaty relief.

Republic of Srpska

No WHT is levied on dividends paid to foreign companies subject to a 10 percent participation rule, which is subject to tax treaty relief. As of 1 January 2012, Property Tax Law applies to all immovable property. Certain exceptions are available.

Non-resident intermediate holding company

As with foreign parent companies non-resident intermediate holding companies have traditionally been used to obtain full advantage of previously available incentives.

Also as with foreign parent companies, WHT applies to dividends and interest paid to a non-resident intermediate company – subject to tax treaty relief.

Local branch

Foreign legal entities cannot have local branch offices in FBiH or RS.

Joint venture

Although uncommon, joint ventures are usually corporate.

Choice of acquisition funding

Common methods of financing are debt and equity.

Debt

The main advantages of debt financing are general interest deductibility and greater flexibility, as no registration with the relevant court is required.

Deductibility of interest

Generally, the tax treatment of interest follows the accounting treatment. (IFRS is applicable in BiH). In both FBiH and RS, the general transfer pricing rules (arm's length principle) apply. There is no maximum interest rate for interest charged by a foreign related-party to BiH.

There are no thin capitalization rules.

Withholding tax on debt and methods to reduce or eliminate it

Payments of interest are subject to 10 percent WHT. The rate of WHT may generally be reduced or eliminated under a tax treaty.

Checklist for debt funding

There are no specific tax provisions that re-characterize debt funding as equity funding.

Equity

The use of equity generally offers less flexibility as any change in share capital must be registered with the relevant court. However, equity may have some non-tax advantages.

Also, equity is generally preferable where the target is loss-making and it is not possible to obtain immediate tax relief for interest payments.

Hybrids

Hybrids currently are not used in BiH (especially given that branch offices cannot be registered either in FBiH or RS).

Discounted securities

Although uncommon, the tax treatment of securities issued at a discount to third parties should normally follow the accounting treatment.

Deferred settlement

An acquisition sometimes involves an element of deferred consideration. The tax treatment of a right to receive an unknown amount in future generally follows the accounting treatment.

Other considerations

Concerns of the seller

The tax position of the seller can be expected to significantly influence any transaction, so it is advisable to investigate tax implications before making any commitments.

Company law and accounting

Company laws applicable in FBiH and RS prescribe how companies may be formed, operated, reorganized and dissolved. For example, foreign legal entities cannot register a branch office in FBiH due to restrictive provisions of the Registered Legal Entities Law of FBiH. However, foreign legal entities, in accordance with the Registered Legal Entities Law of RS, are able to register a branch office in RS.

For entities in both FBiH and RS, the relevant laws prescribe that distribution of profit may be only made out of a company's distributable reserves.

From the accounting perspective, IFRS is fully applicable in BiH.

Group relief/consolidation

Tax grouping is generally allowed for entities in both FBiH and RS under certain conditions.

Transfer pricing

Where post-acquisition transactions between the parties involved are not on an arm's length basis, transfer pricing issues may arise in the relevant jurisdictions.

Foreign investments of a local target company

There are no controlled foreign company (CFC) rules in BiH.

Comparison of asset and share purchases

Advantages of asset purchases

- Possible to acquire only part of a business.
- Previous liabilities of the company are not inherited.

Disadvantages of asset purchases

- Benefits of any tax losses incurred by the target company generally remain with the seller.
- May give rise to VAT where not classified as a going concern.
- May give rise to irrecoverable transfer taxes (e.g. on land, vehicles).

Advantages of share purchases

- Buyer may benefit from tax losses of the target company.
- Likely more attractive to the seller, so the price may be lower.

Disadvantages of share purchases

- Buyer effectively becomes liable for any claims or previous liabilities of the entity.

Bosnia and Herzegovina – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under BiH's tax treaties. This table is based on information available up to 1 February 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Domestic rates				
<i>Companies:</i>	0/5	0/5	0/10	10
<i>Individuals:</i>	0/10	N/A	0/10	10
Treaty rates				
<i>Treaty with:</i>				
Albania	10	5	10	10
Algeria	10	10	0/10	12
Austria	10	5	5	5
Belgium ³	15	10	15	10
China (People's Rep.)	10	10	10	10
Croatia	10	5	10	10
Cyprus	10	10	10	10
Czech Rep.	5	5	0	10

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Denmark	15	5	0	10
Finland	15	5	0	10
France	15	5	0	10
Germany	15	15	0	10
Hungary	10	10	0	10
Ireland ⁴	0	0	0	0
Italy	10	10	10	10
Moldova	10	5	10	10
Montenegro ⁵	10	5	10	10
Netherlands	15	5	0	10
Norway	15	15	0	10
Poland	15	5	10	10
Romania	5	5	7.5	10
Serbia	10	5	10	10
Slovak Rep.	15	5	0	10
Slovenia	10	5	0/7 ⁶	5
Spain	10	5 ⁷	7	7
Sri Lanka	12.5	12.5	10	10
Sweden	15	5	0	0
Turkey	15	5	10	10
United Kingdom	15	5	10	10

Notes:

1. Some treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. Unless stated otherwise, the reduced treaty rates given in this column generally apply if the recipient company holds directly or indirectly holding is at least 25 percent of the capital or of the voting power, as the case may be, of the company distributing dividends.
3. Tax treaty concluded by the former Socialist Federal Republic of Yugoslavia or by the Federal Republic of Yugoslavia, as the case may be.
4. Effective from 1 January 2013.
5. Tax treaty concluded between Bosnia and Herzegovina and the former Serbia and Montenegro.
6. The lower rate applies to interest paid by public bodies.
7. The reduced rate applies if the recipient company owns directly at least 20 percent of the capital of the paying company.

KPMG in Bosnia and Herzegovina

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