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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 this complexity, 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 in part to the worsening global financial climate and also to the lack of official guidance and practice regarding BiH's complex taxation system.

This report provides general information on M&A provisions in BiH that have been in place since 2016 in both the RS and the FBiH.

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

New corporate profit tax (CPT) laws were adopted in 2015 and 2016 in the RS and the FBiH respectively, and both are applicable as of 2016.

The main provisions of CPT laws 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 book values.

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 book values.

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 the FBiH include the following:

— 30 percent CPT incentive in the year of investment, when the taxpayer invests 50 percent of profit from its own funds from a tax period in production equipment (excluding passenger vehicles)

— 50 percent CPT incentive in the years of investment for a 5-year period where the taxpayer invests 20 million Bosnian convertible marks (BAM; approximately 10 million euros — EUR) from its own funds in fixed assets used for production activities (excluding residential units and passenger vehicles). BAM4 million (approximately EUR2 million) must be invested in the first year.

The taxpayer is authorized to use only one of the above incentives during 1 tax period.

Taxpayers lose the incentives set out above where:

— they make a dividend payment from the profits covered by the incentive within 3 years after the last year in which the tax incentives were used

— they do not meet the investment requirements during the 5-year period as required

— they use the right to transfer tax losses within 2 years after the last year in which the tax incentives were used.

In the event of loss of incentives as set out above, the taxpayer is obliged to pay the difference in CPT as though no incentives existed, together with late interest.

Another FBiH tax incentive is the right to a tax-deductible expense that amounts to double the amount of paid gross salaries to newly employed employees where:

— the duration of employment is at least full-time for 12 months

— the new employee has not been employed by the taxpayer or a related party within the last 5 years.

Republic of Srpska

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

— a reduction in the CPT base up to the amount corresponding to the value of the investment in equipment, facilities and real estate used for the purposes of conducting registered business manufacturing activities, provided the equipment, facilities and real estate are not sold within 3 years from the day that the equipment, facilities and real estate are put into use; if the taxpayer sells or in another way disposes of the equipment, facilities and real estate within the 3-year period, it must repay the amount of reduced tax on this basis, with interest

— 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, registered with the RS Unemployment Agency, for an indefinite term within 1 tax period; where the taxpayer does not keep all 30 employees for a 3-year period, it must repay the amount of tax and social security contributions by which it reduced its CPT base in the prior periods, with interest.

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

— payments for intellectual property rights, management, technical and educational services (including market research, tax advisory, consulting and audit services)

— payments for lease of movable and immovable property

— payment for entertainment and sports events

— insurance premiums for insurance or reinsurance of risks in FBiH

— payments for telecommunication services

— payments for other services to non-residents with which BiH does not have a signed tax treaty.

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.

Income that a non-resident receives from a resident or a non-resident in FBiH, on the basis of sale or transfer with compensation for real estate, stocks or shares in capital that are considered long-term financial placements and industrial property rights, is considered as taxable income of the non-resident, unless regulated differently in an applicable tax treaty.

The non-resident is obliged to report this income and make an appropriate payment of tax independently or via a representative to the tax administration office in the municipality where the real estate is located or where the company whose shares are being sold is registered, within 30 days of receiving the income. If the non-resident does not file a tax report and make the payment within the 30 days, then the tax should be paid by the purchaser of the real estate or the resident whose shares are being transferred.

Republic of Srpska

WHT applies to certain payments made to non-resident legal entities, including:

— dividends

— specified interest payments

— payments for intellectual property rights, music, entertainment, art or sports programs

— payments for market research, advertising and promotion

— payments for management, consulting, tax advisory, business advisory, accounting, legal and audit services

— insurance premiums

— payments for telecommunication services

— lease of movable property.

The WHT rate is generally 10 percent. A rate of 5 percent applies to dividend payments.

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 FBiH CPT law, 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 the 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 to 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, goodwill is not subject to annual amortization.

Depreciation

Federation of Bosnia and Herzegovina

Depreciation of assets is generally recognized for tax purposes up to the amounts and under the conditions prescribed by the CPT law.

Republic of Srpska

Depreciation of assets is generally recognized for tax purposes up to the amounts and under the conditions 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 (EU) 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, whereas input VAT is fully or partially deductible at the time the property is 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.

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 to 0.20 percent (0.10 percent for real estate in which production activities are undertaken) of the total asset value, depending on the municipality/city.

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 (for 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 1 tax year can be carried forward and deducted from a tax base for 5 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 KPMG in BiH is not aware of any guidance from the tax authorities on the tax treatment of advance dividend. In practice, advance dividends are not common.

There are no explicit limitations on the 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 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 FBiH and RS entities are not taxable (payments from resident to resident), 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.

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

Traditionally, the most commonly used acquisition vehicle has been a foreign parent company.

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

Non-resident intermediate holding company

As with foreign parent companies, non-resident intermediate holding companies have traditionally been used.

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 can have local branch offices in the FBiH and the 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

In both the FBiH and the RS, the general transfer pricing rules (arm's length principle) apply. No maximum interest rate is prescribed for interest charged by a foreign related party to BiH.

There are no thin capitalization rules in the RS.

In the FBiH, financial expenses for interest per financial agreements and instruments to related parties are generally recognized for tax purposes. However, if the ratio of these obligations per financial agreements and the registered share capital of a taxpayer exceeds the ratio of 4:1, then the financial expenses exceeding the 4:1 are not tax recognizable and cannot be transferred to another tax period. However, this does not apply to banks and insurance companies.

Withholding tax on debt and methods to reduce or eliminate it

Payments of interest are subject to 10 percent WHT. Generally, a tax treaty may reduce or eliminate the rate of WHT.

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.

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 the 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 the FBiH and the RS prescribe how companies may be formed, operated, reorganized and dissolved. For example, foreign legal entities can register a branch office in the FBiH. However, due to restrictive provisions of the Registered Legal Entities Law of the FBiH, such registration is still pending. In accordance with the Registered Legal Entities Law of RS, foreign legal entities are able to register a branch office in RS.

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

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

Group relief/consolidation

Tax grouping is generally allowed in the FBiH under certain conditions.

Transfer pricing

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

Foreign investments of a local target company

There are no controlled foreign company 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 2016.

Source: Official Gazette of Bosnia and Herzegovina, Bosnia and Herzegovina Ministry of Finance and Treasury, 2016

	WHT rate (%)		
	Interest	Dividends	Royalties
Treaty with:			
Albania	10	5	10
Algeria	10	10	10
Austria	5	5	5
Azerbaijan	10	10	10
Belgium	10	10	10
China	10	10	10
Croatia	10	5	10
Cyprus	10	10	10
Czech Republic	N/A	5	10
Egypt	15	15	15
Finland	N/A	5	N/A
France	N/A	5	N/A
Germany	N/A	15	10
Greece	10	5	10
Hungary	N/A	10	10
Iran	10	10	15
Ireland	N/A	N/A	N/A
Italy	10	10	10

	WHT rate (%)		
	Interest	Dividends	Royalties
Jordan	10	5	10
Kuwait	5	5	10
Macedonia	10	5	10
Malaysia	10	5	8
Moldova	10	5	10
Montenegro[2]	10	5	10
Netherlands	N/A	5	10
Norway	N/A	15	10
Pakistan	20	10	15
Poland	10	5	10
Qatar	10	7	7
Romania	7,5	5	10
Serbia	10	5	10
Slovak Republic	N/A	5	10
Slovenia	7	5	5
Spain	7	10	7
Sri Lanka	10	12.5	10
Sweden	N/A	5	N/A
Turkey	10	5	10
United Arab Emirates	10	10	5
United Kingdom	10	5	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 or export credit institutions, or in relation to sales on credit. Such exemptions are not considered in this column.

2 Tax treaty concluded between Bosnia and Herzegovina and the former Serbia and Montenegro.

KPMG in Bosnia and Herzegovina

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