



Taxation of cross-border mergers and acquisitions

Slovenia

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Introduction

Slovenia has a small and open economy. These qualities have informed the design of its tax system, which aims at simplicity, as reflected in the limited number of taxes and uncomplicated administrative procedures. Slovenia's business friendliness is evident in its general investment incentives, its special tax regime for new investments in special economic zones and its even-handed treatment of residents and non-residents.

Recent developments

There have been no significant changes in the tax legislation that affects the tax environment for mergers and acquisitions (M&A) since 2007. Partly because of a lack of practical tax experience and limited tax history, however, there are still many open questions in Slovenia about the tax treatment of different transaction structures.

Asset purchase or share purchase

An acquisition in Slovenia can take the form of a purchase of the shares of a company or of a business and assets. The form of acquisition is determined by tax and commercial factors. The transfer of ownership interests is legally simpler than the transfer of numerous assets. It is easier to specify interests or shares purchased than to identify individual assets.

Purchase of assets

A purchase of assets is likely to result in taxation at the level of corporate income tax to the seller if a profit on the sale is realized. Any losses incurred by the seller can be used to offset the profit. Generally, historical tax liabilities remain with the seller and are not transferred with the assets.

Purchase price

It is necessary to allocate the total consideration among the assets acquired, and it is generally advisable to specify the allocation in the purchase agreement.

Goodwill

The tax treatment of goodwill generally aligns with its accounting treatment. Under International Financial

Reporting Standards (IFRS) and SRS (Slovenian accounting standards), goodwill is subject to an impairment test (and not annual amortization). For tax purposes, expenses resulting from impairment of goodwill are recognized for up to 20 percent of the original value. It is also possible to carry forward the excess impairment of goodwill.

Depreciation

Tax depreciation generally is recognized as expenditure in the calculated amount but not exceeding the amount arrived at using the straight-line depreciation method. The maximum annual depreciation rates are as follows:

Depreciation category	Maximum annual depreciation (%)
Building projects, including investment property	3
Parts of building projects, including parts of investment property	6
Equipment, vehicles and machinery	20
Parts of equipment and equipment for research	33.3
Computers and computer equipment	50
Long-term plantations	10
Breeding and working herds	20
Other assets	10

Tax attributes

Tax losses are not transferred on an asset acquisition. They remain with the company or are extinguished.

Value added tax

Valued added tax (VAT) is levied at the rate of 22 percent on a large number of goods and services, although the supply of goods to another member state of the European Union (EU) or to third countries is exempt from VAT. The transfer of a business as a going concern is outside the scope of VAT, provided certain conditions are met. Professional advice should be sought where land or buildings are being sold because the transferor might bring them within the scope of VAT.

Transfer taxes

Generally, there are no stamp duties on a transfer of assets; however, real estate transfer tax might arise. In general, a transfer of real estate is subject to real estate transfer tax of 2 percent of the purchase price unless VAT is charged.

Purchase of shares

A share deal does not offer the buyer a step-up (capitalization of assets at fair market value) of the assets of the purchased company to increase the depreciation base.

Tax indemnities and warranties

In a share acquisition, the purchaser takes over the target company together with all related liabilities. Consequently, the purchaser normally requires more extensive indemnities and warranties than in the case of an asset acquisition. For large deals, a due diligence exercise is recommended, including a review of the target's tax affairs.

Tax losses

In general, tax losses can be carried forward indefinitely. However, where direct or indirect ownership of capital or voting rights change by more than 50 percent in a tax year and other statutory conditions are not met, tax losses cannot be carried forward.

Pre-sale dividend

In certain circumstances, a pre-sale dividend may be the seller's preferred option. The dividend payment is unlikely to be subject to Slovenian tax if it is paid to a resident corporate shareholder and reduces the proceeds from the sale and thus the resulting gain, which may be taxed at 17 percent (the possible exemption of 50 percent of capital gains at corporate shareholder level should be considered; see this report's section on equity).

However, each case must be examined on its facts.

Transfer taxes

There are no stamp duties on transfers of shares in Slovenia.

Choice of acquisition vehicle

Various acquisition vehicles are available to a foreign purchaser of a Slovenian business, but there have been few M&A-type transactions so far. As a result, tax practice in this field is still developing. Moreover, the Corporate Income Tax Act stipulates no particular tax treatment for different acquisition vehicles. Most acquisitions in Slovenia are achieved by establishing a new company to buy the target and then merging the target with the acquirer, or vice versa.

Choice of acquisition funding

A purchaser must decide whether to fund the acquisition by means of debt, equity or a hybrid instrument.

Debt

The principle advantage of debt is the potential tax deductibility of interest. The payment of a dividend does not give rise to a tax deduction.

If it is decided to use debt, further decisions must be made as to which company should borrow the funds and how the acquisition should be structured.

A typical structure uses a Slovenian company as the acquisition vehicle. The company funds the purchase with debt from a related party or a bank and offsets interest paid against the target's profit. Problems may arise where the target's profit is not sufficient to absorb the interest because tax grouping is no longer possible in Slovenia.

Deductibility of interest

Generally, a company's accounting treatment of interest is followed for tax purposes.

There are limitations on the tax-deductibility of interest. In general, taxpayers may deduct all substantiated expenses directly connected to or resulting from the taxable business activity. Interest paid on loans from persons or entities resident in low-tax jurisdictions (listed by the Ministry of Finance) is not tax-deductible.

Interest resulting from financing the acquisition of a target company may be deductible in Slovenia on the level of a buyer, provided the funding complies with Slovenia's thin capitalization and transfer pricing rules.

In the case of mergers (buyer merges with a target or vice versa), the possibility of debt pushdown should be investigated on a case-by-case basis because, in the tax authority's opinion, such interest is not tax-deductible in Slovenia. This area is still unclear and requires careful attention.

The general transfer pricing rule is that interest charged by affiliated persons is tax-deductible, as long as the interest does not exceed the level of the most recently published (at the time the loan is granted), known and recognized interest rate. The recognized interest rate is determined and published by the minister responsible for finance prior to the beginning of the tax period to which it applies. Non-deductible interest could be mitigated where the company demonstrates that it could raise the loans from a non-related lender on the same terms.

Thin capitalization rules are applicable for interest expenses incurred on loans from qualified shareholders other than banks and insurance companies. A company is regarded as a qualified shareholder if it directly or indirectly holds at least 25 percent of the shares in the other company's capital or voting rights at any time in the tax year. Loans granted by a sister company are treated as loans granted by direct or indirect shareholders for thin capitalization purposes, so they are subject to thin capitalization rules. Additionally, loans granted by a third party and guaranteed by qualified shareholders and loans granted in connection with a deposit held by qualified shareholders (back-to-back loans) should be considered when determining the thin capitalization ratio.

Any interest expense incurred on such loans is not deductible from the corporate income tax (CIT) base if, at any time in the tax year, the debt-to-equity ratio exceeds 4:1.

Non-deductible interest could be mitigated where the company demonstrates that it could raise the excess loans from a non-related lender on the same terms.

Withholding tax on debt and methods to reduce or eliminate it

Payments of interest by a Slovenian company to a resident or non-resident are subject to withholding tax (WHT) at 15 percent. The rate of WHT may be reduced or eliminated under a tax treaty or, if the recipient is a company resident in another EU member state, under the EU Interest and Royalties Directive.

There is no WHT if the recipient is a resident and notifies the Slovenian-resident payer of its tax number.

Prior approval of the Slovenian tax authorities is needed before the reduced (zero) rate on WHT on interest can be applied.

Checklist for debt funding

- The use of bank debt may avoid thin capitalization and transfer pricing problems and should obviate the requirements to withhold tax from interest payments.
- No group relief is possible.
- In a merger, the possibility of debt pushdown should be investigated on a case-by-case basis. The tax authorities take the view that such interest is not tax-deductible in Slovenia.
- WHT of 15 percent applies on interest payments to non-Slovenian entities unless a lower rate applies under the relevant tax treaty/EU directive and advance approval is obtained.

Equity

A purchaser may use equity to fund its acquisition. Slovenia has no capital duty, and stamp duty is not levied on issues of new share.

Companies pay dividend WHT at a rate of 15 percent on each distributed dividend to residents and non-residents of Slovenia. Where a tax treaty stipulates a tax rate lower than 15 percent, the treaty rate applies. There is no WHT where a resident taxpayer notifies the payer of its tax number or where a non-resident taxpayer operating a permanent establishment in Slovenia notifies the payer of its tax number.

No tax is withheld for payments of dividends and income similar to dividends distributed to shareholders on the basis of the EU Parent-Subsidiary Directive where at least 10 percent equity has been held for at least 24 months.

Additionally, dividends are not subject to WHT in Slovenia if the (dividend) income is paid to a non-resident who is a resident of an EU and/or European Economic Area (EEA) member state other than Slovenia and is liable for tax on income in the country of residence. In this case, the dividend recipient cannot claim WHT paid in Slovenia in the country of residence and the purpose of the transaction cannot be a tax avoidance.

When calculating the tax base, the taxpayer may exempt received dividends and similar income, except hidden reserves, if the payer is liable to pay CIT. The exemption also applies to a resident of an EU member state that is liable to pay tax comparable to CIT, provided the taxpayer is not a resident of a country (or in the case of a permanent establishment, not situated in a country) in which the general, average nominal level of tax on corporate profits is less than 12.5 percent.

These provisions also apply to a non-resident recipient if the recipient's participation in the equity capital or management of the person distributing profits is connected with business activities performed by the non-resident in or through a permanent establishment in Slovenia.

Capital gains from the sale of shares are subject to CIT as normal income. Half of the capital gains on a disposal of shares are tax-exempt where these conditions are met:

- The shares represent a participation of at least 8 percent of the capital the voting rights in the company.
- The shares have been held for at least 6 months.
- During the holding period, the taxpayer employed at least one person.
- The participation is not in a company resident in a low-tax jurisdiction.

However, 50 percent of capital losses realized on a sale of shares under the special participation exemption regime is not tax-deductible.

If the seller of the shares is not resident for tax purposes in Slovenia, capital gains from the sale of shares are not subject to CIT, provided the shares sold are not attributable to the seller's permanent establishment in Slovenia.

Tax-neutral restructuring

Tax-neutral restructuring in Slovenia may be done through a merger, division, transfer of assets or exchange of shares. If the requirements of the EU Merger Directive are met, restructuring could be done tax-free.

Tax-neutral domestic reorganization has been possible since Slovenia joined the EU but was limited to Slovenian corporate taxpayers with a legal seat in Slovenia. From 31 January 2008, cross-border mergers also may be carried out by companies having their registered seat in other EU member state and operating in a legal form listed by the EU Merger Directive.

Hybrids

There are no specific tax provisions in the Corporate Income Tax Act dealing with the tax treatment of different hybrids. However, the law stipulates that profit distributed to holders of securities and loans that carry rights of participation in the payer's profits are treated as expenditures similar to dividends.

Discounted securities

The tax treatment of securities issued at a discount to third parties normally follows the accounting treatment. There is no specific provision in the Corporate Income Tax Act regarding the tax treatment of discounted securities.

Other considerations

Concerns of the seller

The tax position of the seller can be expected to have an important influence on any transaction.

In certain circumstances, the seller may prefer to realize part of the value of their investment as income by means of a pre-sale dividend. The position is not straightforward, however. Slovenian individuals are subject to a flat tax rate of 25 percent, with a reduction of the tax rate for every completed 5-year period of ownership of the capital. As a result, the following tax rates apply:

- after 5 years, 15 percent
- after 10 years, 10 percent
- after 15 years, 5 percent
- after 20 years, 0 percent.

Company law and accounting

The Company Act prescribes how Slovenian companies may be formed, operated, reorganized and dissolved.

Business activities in Slovenia are mainly carried out through one of the following legal forms.

Limited liability company (*družba z omejeno odgovornostjo — d.o.o.*)

The limited liability company (LLC) is the most common form of business association. It is a corporate entity with its own legal personality. It has one or more shareholders and share capital of at least 7,500 euros (EUR). Shares are not certified. The purchase and transfer of shares in an LLC requires a written agreement, which must be recorded before a notary (in notarized form). The management of an LLC rests with one or more managing directors appointed by shareholders. The shareholders also control the distribution of net earnings.

Stock corporation (*delniška družba — d.d.*)

The stock corporation is also a corporate entity with its own legal personality. The minimum share capital is EUR25,000. The stock corporation usually has a management board and supervisory board. The management board is in charge for the management of the stock corporation and represents it. The members of the management board are appointed and removed by the supervisory board. The supervisory board monitors the management board and represents the stock corporation in relation to the management board. Members of a supervisory board are elected by the shareholders. Stock corporation shares do not need to be transferred in notarized form.

Other forms

Slovenian company law also recognizes the following forms:

- general partnership (*družba z neomejeno odgovornostjo — d.n.o.*)
- limited partnership (*komanditna družba — k.d.*)
- limited partnership with share capital (*komanditna delniška družba*)
- societas Europae.

All of these forms are legal entities with their own legal personalities and are subject to CIT in Slovenia.

For the accounting of business combinations in Slovenia, the provisions of IFRS 3 — Business Combinations directly apply.

A business combination is the bringing together of separate enterprises (business entities) into one reporting entity.

Business combinations are accounted for by applying the purchase method. At the acquisition date, the acquirer allocates the costs of a business combination by recognizing the acquiree's intangible assets, liabilities and contingent liabilities at their fair value at that date, other than noncurrent assets, which are recognized at fair value less selling costs. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities is accounted for as goodwill.

Group relief/consolidation

There is no group taxation regime in Slovenia.

Before 2007, the tax system allowed the use of a group taxation scheme between resident taxpayers with the permission of the tax authorities, generally for 3 years. Groups were allowed to continue after 2006 until the expiry of the taxation period indicated in the permission.

Transfer pricing

In establishing a taxable person's income, the transfer prices paid by affiliated persons for assets, including intangible assets, and services are considered. The transfer prices should be no less than the prices that comparable assets and service in comparable circumstances would command in a market of non-affiliated persons (comparable market prices).

In establishing a taxable person's expenditures, the transfer prices paid to affiliated persons for assets, including intangible assets, and services are considered. The expenditures should not exceed the comparable market prices.

Comparable market prices are fixed by using either one or a combination of the following methods:

- comparable prices on the free market
- resale prices
- cost supplement
- profit distribution
- net profit rate
- another method.

As defined in the CIT Act, 'affiliated persons' include:

- a taxable resident that directly or indirectly holds no less than 25 percent of the value or number of shares or equity holdings or voting rights of a foreign person
- a foreign person that directly or indirectly holds no less than 25 percent of the value or number of shares or equity holdings or voting rights of a resident
- a legal person that directly or indirectly holds no less than 25 percent of the value or number of shares or holdings or voting rights either of a resident and foreign person, or of two residents
- a natural person(s) or members of their families that directly or indirectly hold no less than 25 percent of the value or number of shares , holdings or voting rights, or participate in the supervision or management either of a resident and a foreign person, or of two residents.

Dual residency

There is no dual residency in Slovenia. Residency is determined by the place of establishment or place of effective management. In Slovenia's tax treaties, the predominant criterion is the place of effective management.

Foreign investments of a local target company

To prevent Slovenian companies from accumulating profits offshore in low-tax countries, domestic legislative changes were introduced in January 2007. As a result, a 15 percent WHT applies to payments of certain services to an entity with a registered office or actual management in jurisdictions with general or average nominal CIT rates lower than 12.5 percent and listed on the blacklist (EU countries are exempt).

Additionally, interest costs on loans received from companies with registered offices or actual management in jurisdictions with general or average nominal CIT rates lower than 12.5 percent and listed on the blacklist, are not tax-deductible.

Comparison of asset and share purchases

Advantages of asset purchases

- Possible to acquire only those assets that are desired or only a part of the business.
- If the purchase is funded by debt, the interest may be tax-deductible, provided the assets are used for carrying on taxable business.
- Liabilities usually are not inherited (unless there is a purchase of a business).
- Purchase price of the assets can be depreciated for tax purposes.

Disadvantages of asset purchases

- Approval of shareholders is sometimes required.
- Legally more complicated (e.g. notification of suppliers, change of employment contracts, each individual component needs to be transferred).
- Tax losses are not transferred to the acquiring company.
- May be unattractive to the seller, especially if capital gains from a share sale would be exempt from taxation.

Advantages of share purchases

- Legally simpler (no need for transfer of contracts with suppliers and employees).
- Buyer may benefit from tax losses of the target company.
- Generally, 50 percent of capital gains on the disposal of shares is exempt, in certain conditions.
- Where the seller is not resident in Slovenia and has no permanent establishment in Slovenia, a sale of shares is not subject to corporate income tax.

Disadvantages of share purchases

- Tax depreciation is unaffected by the amount of the purchase price.
- Acquisition of all business-related liabilities.
- If a merger follows the acquisition, the debt pushdown might not be tax-deductible.

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