



MERGERS AND ACQUISITIONS

Bosnia and Herzegovina

Taxation of Cross-Border Mergers and Acquisitions

2010 Edition

TAX

Bosnia and Herzegovina

Introduction

Bosnia and Herzegovina (BiH) is administratively divided into two entities, the Federation of Bosnia and Herzegovina (FBiH), and the Republic of Srpska (RS). Indirect taxes are regulated at the state level; that is, at the level of BiH, and direct taxes are regulated on 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 was a relatively attractive market to foreign investors, resulting in a number of successful mergers and acquisition (M&A) projects. In recent years, however, there has been a decrease in M&A activity, partly because of the worsening global financial climate, and partly because of the recent changes in the fiscal system of BiH, and a lack of official guidance and practice.

This chapter provides general information of M&A in BiH including changes that took effect on 1 January 2008 and will focus on the FBiH, given that there have been no significant changes in the corporate profit tax (CPT) legislation of the RS.

Note, however, that despite the number of mergers and acquisitions that took place in BiH in recent years, the BiH tax system is still relatively immature. This means that, a number of structuring options available in other jurisdictions have not been used in BiH, and KPMG in Bosnia and Herzegovina cannot, therefore, comment on them.

Recent Developments

A new Corporate Profit Tax (CPT) Law was enacted in the RS as of 1 January 2007. The FBiH followed the reform by adopting a new CPT Law applicable in the FBiH as of 1 January 2008. The comments below relate to changes in relevant legislation as of 1 January 2008, and are thus focused on the changes in the FBiH legislation.

The main changes brought about by the new CPT Law in the FBiH were:

- the previous CPT Law in the FBiH did not address mergers and acquisitions;

- the new law introduced new incentives;
- the CPT rate was reduced from 30 percent to 10 percent; and
- a mechanism was introduced for the practical implementation of double tax treaties (DTTs) and a wider withholding tax (WHT) scope was defined.

The changes are summarized in the following paragraphs.

Mergers and Acquisitions

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

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

There have not been many instances of mergers and acquisitions in BiH since the introduction of the new CPT Laws, so it has not been possible to witness the application of new CPT provisions in practice in either of the two entities.

Incentives

The new CPT Law in the FBiH abolished previously available incentives, including amongst others, reinvestment of taxable profits and tax holidays for foreign investments, but it also introduced new incentives for exporters and investments of over BAM 20 million over a five-year period.

The current provisions allow the use of tax incentives that commenced prior to the new CPT Law in the FBiH coming into force to continue until they expire in line with the provisions of the previous CPT Law.

Rates

The new CPT rate in the FBiH is 10 percent.

Withholding Tax (WHT)

The most significant change introduced by the new FBiH CPT Law was, however, widening the scope of WHT. Previously WHT was due on interest, dividends, and royalties paid to non-residents. The new CPT Law stipulated that WHT is due on basically all income generated in the FBiH by non-residents (who have no permanent establishment [PE] in the FBiH). As noted earlier in the chapter, another important change was the introduction of mechanism for the practical implementation of DTTs.

New CPT Law in the FBiH reduced the standard WHT rate from 15 percent to 10 percent, and introduced a reduced WHT rate of 5 percent on dividend payments.

Asset Purchase or Share Purchase Purchase of Assets

A purchase of assets will generally result in an increase in the purchaser's tax base in those assets.

In accordance with the new CPT Law in the 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 IAS/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. However, the purchaser still may inherit flawed reporting or compliance. It is thus advisable for the purchaser to carry out a due diligence to detect such potential problems.

Goodwill

Tax treatment of goodwill follows the IFRS treatment: goodwill is subject to the impairment test, and not to annual amortization.

Depreciation

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.

Tax Attributes

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

Value-Added Tax (VAT)

VAT in BiH is levied at the state level and generally complies with the EU VAT Directive.

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

As a general rule, the transfer of a part of a taxpayer's property shall be considered as a sale of goods for consideration, subject to VAT, if 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 of 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 might be subject to real estate transfer tax, which is levied at the level of cantons in the FBiH, of which there are ten. The RS levies its own real estate transfer tax which was expected to change as of 1 January 2010.

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 Indemnities and Warranties

Generally, more extensive indemnities and warranties are required in a share acquisition where the purchaser is taking over the target company together with all related liabilities, including contingent liabilities.

It is not unusual for the purchaser to initiate a due diligence exercise incorporating normally a review of the target's tax affairs.

Tax Losses

In an acquisition of shares, carried forward tax losses previously generated by a target company will, in principle, transfer along with the company. In both the FBiH and the 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

Statute of limitations for tax liabilities is generally five years, unless there is a suspicion of fraud. 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. Also, in practice, advance dividends are not common. However, there are no explicit limitations to payment of advance dividends, except that they are subject to final assessment of profits at the 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 or, in case of loss, the recipient of advance dividends is obliged to refund them or keeps them as advance dividends for future periods.

Transfer Taxes

There is no stamp duty on a sale of shares.

Choice of Acquisition Vehicle

Local Holding Company

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

Foreign Parent Company

The most commonly-used acquisition vehicle has traditionally been a foreign parent company, due to the incentives that were available to foreign investors in the FBiH.

However, dividends and interest paid to non-residents by the FBiH resident are, amongst other type of payments, subject to WHT, subject to DTT relief.

Note that real estate transfer tax is currently regulated at the level of cantons in the FBiH, but generally if a foreign company owns a BiH company that only owns land, a sale of those shares will not be subject to real estate transfer tax.

Non-Resident Intermediate Holding Company

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

Generally DTTs applicable in BiH do not contain treaty shopping provisions.

As with foreign parent companies, dividends and interest paid to a non-resident intermediate company are, among other types of payments, subject to WHT, subject to DTT relief.

Local Branch

Foreign legal entities cannot have local branch offices in the FBiH.

Joint Ventures

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 speaking, a company's accounting treatment of interest will be followed for tax purposes (IFRS is applicable in BiH).

Note that the FBiH has general transfer pricing rules (arm's length principle). There is no maximum rate of interest for interest charged by a foreign related-party to BiH.

There are no thin-capitalization rules in the FBiH.

Withholding Tax on Debt and Methods to Reduce or Eliminate

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

Checklist for Debt Funding

There are no specific tax provisions that would 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, but it might have some non-tax advantages. Also, it is generally preferable when the target is loss-making and when it is not possible to obtain immediate tax relief for interest payments.

Hybrids

Not developed (especially given that branch offices cannot be registered in the FBiH).

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. In this case tax treatment of the right to receive an unknown amount in future should generally follow the accounting treatment.

Other Considerations

Concerns of the Seller

The tax position of the seller can be expected to have a significant influence on 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. The rules are relatively restrictive and, for example, foreign legal entities cannot have branch offices in BiH. In both entities 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 in the FBiH under certain conditions.

Transfer Pricing

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

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

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

Disadvantages of Asset Purchases

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

Advantages of Share Purchases

- The buyer may benefit from the tax losses of the target company.
- It is likely to be more attractive to the seller, so the price may be lower.

Disadvantages of Share Purchases

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

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