



MERGERS AND ACQUISITIONS

Slovenia

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Slovenia

Introduction

Slovenia has a small and very open economy. These qualities have been taken into account in the design of the 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 the general investment incentives, the special tax regime for new investments in special economic zones, and 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 tax practice 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 takes the form of a purchase of the shares of a company or of a business and assets. The form of an 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 in the hands of the seller, if a profit on the sale is realized. If the seller incurs losses, they can be used to offset the profit. Historical tax liabilities generally 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 for the purchase agreement to specify the allocation.

Goodwill

In general tax treatment of goodwill is aligned with its accounting treatment. Under IFRS and SRS (Slovenian accounting standards) goodwill is subject, not to annual amortization, but to an impairment test. For tax

purposes, expenses resulting from impairment of goodwill are recognized up to the amount of 20 percent of the original value. It is also possible to carry forward the excess impairment of goodwill.

Depreciation

In general tax depreciation shall be 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 (VAT)

VAT is levied at the rate of 20 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. Taking advice is recommended, if land or buildings are being sold, because the transferor might put them within the scope of VAT.

Transfer Taxes

In general there are no stamp duties on transfer of assets; however, real estate transfer tax might arise. In general transfer of real estate is subject to 2-percent

real estate transfer tax on 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 is taking over the target company together with all related liabilities. Consequently, the purchaser will normally require more extensive indemnities and warranties than in the case of an asset acquisition. For large deals a due diligence exercise is recommendable, which would include a review of the target's tax affairs.

Tax Losses

Carried-forward Slovenian tax losses generated by the target company will, in principle, transfer along with the company. In general, tax losses can be carried forward indefinitely, but if direct or indirect ownership of capital or voting right in a tax year changes by more than 50 percent and if other statutory conditions are not met, tax losses cannot be carried forward.

Pre-Sale Dividend

In certain circumstances a pre-sale dividend may be a preferred option for the seller. The dividend payment is unlikely to be subject to Slovenian tax if paid to a corporate shareholder, and reduces the proceeds from and thus the gain on the sale, which may be taxed at 21 percent (a possible exemption of 50 percent of capital gains at corporate shareholder level as described under the Equity section should be taken into consideration). Please note that each case must be examined on its fact.

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 very M&A-type transactions so far. This means tax practice in this field is still developing. Moreover it is important to note that the Corporate Income tax Act stipulates no particular tax treatments for different acquisition vehicles. Most acquisitions in Slovenia have been effected by establishing a new company to buy

the target. Subsequently the target has been merged with the acquirer, or vice versa.

Choice of Acquisition Funding

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

Debt

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

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

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

Deductibility of Interest

Broadly, a company's accounting treatment of interest will be followed for tax purposes.

Please note that there are the certain limitations on the tax deduction of interest. In general, taxpayers may deduct all substantiated expenses directly connected to, or being result of, the taxable business activity, but interest paid on loans from persons or entities resident in low-tax jurisdictions (listed by the Ministry of finance) are not tax deductible.

Interest resulting from financing the acquisition of a target company might be deductible in Slovenia on the level of a buyer, but the funding must comply with thin-capitalization and transfer pricing rules.

In the case of mergers (buyer merges with a target or vice versa), the possibility of debt push down should be investigated on a case by case basis, because in the tax authority's opinion such interest is not tax deductible in Slovenia. Note that 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 of granting the loan known and recognized interest rate. The recognized interest shall be determined and published by the minister

responsible for finance prior the beginning of the tax period to which it apply, considering the fact that the interest rate in question is or would be reached in the market between unaffiliated persons.

Thin-capitalization rules are applicable for interest expenses incurred on loans from qualified shareholders other than banks and insurance companies. A company should be 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 third party and guaranteed by qualified shareholders or granted in connection with a deposit held by qualified shareholders (back-to-back loans) should be taken into consideration for determining the thin-capitalization ratio.

Any interest expense incurred on such loans should not be deducted from the corporate income tax (CIT) base if at any time in the tax year the following statutory debt-to-equity ratios are exceeded:

- 6:1 in 2009 and 2010
- 5:1 in 2011 and
- 4:1 from 2012 onwards.

Non-deductible interest could be mitigated if 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

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 double tax convention 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.

Note that the 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 push down should be investigated on a case by case basis. The tax authority takes the view that such interest should not be tax deductible in Slovenia.
- WHT of 15 percent applies on interest payments to non-Slovenian entities unless a lower rate applies under the relevant double tax treaty/EU directive, and advance approval is obtained.

Equity

A purchaser may use equity to fund its acquisition. Note that 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. If international treaties on the avoidance of double taxation stipulate a tax rate lower than 15 percent, the tax rate from the treaty applies. There is no WHT if a resident taxpayer notifies the payer of its tax number or if the non-resident taxpayer operating in 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 if at least 10 percent equity has been held for at least 24 months).

When calculating the tax base, the taxpayer may exempt received dividends and other similar income, except hidden reserves, if the payer is liable to pay CIT or is a resident of an EU Member State – is liable to pay tax, comparable to the tax according to the CIT Act and 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. The aforementioned 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 corporate income tax as normal income. Half the capital gains on a disposal of shares are exempt from tax provided that:

- the shares represent a participation of at least 8 percent of the capital or the voting rights in the company;
- the shares have been held for at least six months;

- during the holding period at least one person was employed by the taxpayer; and
- 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 are 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 corporate income tax, provided the shares sold are not attributable to the seller's permanent establishment in Slovenia.

Tax Neutral Restructuring

Tax neutral restructuring in Slovenia could be done via merger, division, transfer of assets, and exchange of shares. If the requirements stipulated by the EC Merger Directive are met, restructuring could be done tax-free.

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

Hybrids

There are no specific tax provisions in the Corporate Income Tax Act dealing with the tax treatment of different hybrids, but the act 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 special provision in the CIT act regarding 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 his 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 20 percent with a reduction of the tax rate for every completed five year-period of

ownership of the capital. This means that 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, re-organized, 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 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 EUR 7,500. Shares are not certified. The purchase and transfer of shares in a limited liability company requires a written agreement, which must be recorded before a notary (in notarized form). The management of a limited liability company 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 EUR 25,000. 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

The following forms may also be encountered according to the Slovenian company law:

- General partnership (družba z neomejeno odgovornostjo – d.n.o.)
- Limited partnership (komanditna družba – k.d.)
- Limited partnership with share capital (komanditna delniška družba)
- Societas Europa

All the above-mentioned forms are legal entities with their own legal personalities and are subject to corporate income tax in Slovenia.

For accounting of business combinations in Slovenia the provision of IFRS 3 – Business Combinations shall directly apply.

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

Business combinations shall be accounted for by applying the purchase method. The acquirer shall, at the acquisition date, allocate 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 non-current assets that shall be 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 shall be accounted for as goodwill

Group Relief/Consolidation

There is no group taxation regime in Slovenia.

The tax system effective until 31 December 2006 allowed the use of a group taxation scheme with the permission of the tax authorities, generally for three years, but only between resident tax payers. 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, account shall be taken of the transfer prices paid by affiliated persons for assets, including intangible assets, and services. They should be no less than the prices 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, account shall be taken of the transfer prices paid to affiliated persons for assets, including intangible assets, and services. The expenditures should not exceed the comparable market prices.

Comparable market prices shall be fixed by using either one of the following methods, or any combination of the following methods:

- comparable prices on the free market;
- resale prices;

- cost supplement;
- profit distribution;
- net profit rate; or
- another method.

Affiliated persons defined by the CIT act are as follows:

- the taxable resident 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;
- the foreign person 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;
- the same legal person 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; or
- the same natural persons or the members of their families directly or indirectly hold no less than 25 percent of the value or number of shares or 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. Residency is determined by the place of establishment, or place of effective management. In double tax treaties Slovenia has concluded with other countries, 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 the following provisions in local legislation were introduced in January 2007. Payments of any services to an entity with registered office or with actual management in jurisdictions with general or average nominal CIT rates lower than 12.5 percent and listed on the black list (EU countries are exempt) are subject to a 15-percent WHT.

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

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- It is 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 will be used for carrying on taxable business.
- Liabilities are usually not inherited (unless there is a purchase of a business).
- The purchase price of the assets can be depreciated for tax purposes.

Disadvantages of Asset Purchases

- Approval of shareholders is sometimes required.
- Legally more complicated (notification of suppliers, change of employment contracts, each individual component needs to be transferred, etc.).
- Tax losses are not transferred to the acquiring company;

- It may be unattractive to the seller, especially if capital gains from a share sale would be exempt from taxation.

Advantages of Share Purchases

- Legal simplicity (contracts with suppliers and employees will automatically transfer).
- The buyer may benefit from tax losses of the target company.
- In general 50 percent of capital gains on the disposal of shares is exempt, on certain conditions.
- If 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 push-down might not be tax deductible.

Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)		
Austria	15	5	0/5 ³	5
Belgium	15	5	10	5
Bosnia and Herzegovina	10	5	0/7 ³	5
Bulgaria	10	5	5	5/10 ⁴
Canada	15	5	10	10
China (People's Rep.)	5	5	10	10
Croatia	5	5	5	5
Cyprus*	10	10	10	10
Czech Republic	15	5	5	10
Denmark	15	5	5	5
Estonia	15	5	10	10
Finland	15	5	5	5
France	15	0 ⁵	0/5 ⁶	0/5 ^{4,6}
Germany	15	5	5	5
Greece	10	10	10	10
Hungary	15	5	5	5
India	15	5 ⁷	10	10
Ireland	15	5	5	5
Israel	15	5/10 ⁷	5	5
Italy*	10	10	10	10
Korea (Rep.)	15	5	5	5
Latvia	15	5	10	10
Lithuania	15	5	10	10
Luxembourg ⁸	15	5	5	5
Macedonia	15	5	10	10

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)		
Malta	15	5	5	5
Moldova	10	5	5	5
Montenegro ⁹	10	5	10	5/10 ¹⁰
Netherlands	15	5 ⁷	5	5
Norway*	15	15	0	10
Poland	15	5	10	10
Portugal	15	5	10	5
Romania	5	5	5	5
Russia	10	10	10	10
Serbia ⁹	10	5	10	5/10 ¹⁰
Slovak Republic	15	5 ¹¹	10	10
Spain	15	5	5	5
Sweden*	15	5	0	0
Switzerland	15	5	5	5
Thailand	10	10	10/15 ¹²	10/15 ⁴
Turkey	10	10	10	10
Ukraine	15	5	5	5/10 ¹³
United Kingdom	15	0 ⁵	0/5 ¹⁴	5
United States	15	5	5	5

Notes

- * Treaty concluded by the former Yugoslavia. Slovenia continues to honor such treaties and, in general, treaty parties continue to apply the treaties with respect to Slovenia.
- Many treaties provide for an exemption for certain types of interest, such as 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.
 - Unless indicated otherwise, the rate in this column applies if the recipient company holds at least 25 percent of the capital or voting power of the paying company, as the case may be. Special conditions may apply.
 - The lower rate applies to interest paid by public bodies.
 - The lower rate applies to copyright royalties, excluding cinematograph films, and to equipment rentals.
 - A holding of at least 20 percent is required.
 - The zero rate applies if the French recipient is a company that holds directly at least 20 percent of the capital of the Slovenian company, or vice versa, or a third French or Slovenian company holds directly at least 20 percent of the capital of both the payer and the recipient company.
 - A 10-percent holding is required.
 - The treaty does not apply to exempt Luxembourg holding companies.
 - The treaty concluded between Slovenia and the former Serbia and Montenegro.
 - The lower rate applies to copyright royalties, including films, etc.
 - The rate also applies if the Slovak company is a partner in a Slovak partnership which holds directly at least 25 percent of the Slovenian company.
 - The lower rate applies to interest paid to any financial institution (including an insurance company).
 - The higher rate applies to copyrights of literary or artistic works, including films, etc.
 - The lower rate applies to interest paid by public bodies. It also applies when the payer and the recipient are both companies and either company owns directly at least 20 percent of the capital of the other company, or a third company, being a resident of a contracting state, holds directly at least 20 percent of the capital of both the paying company and the recipient company.

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