Doing M&A in CEE

Tax traps and structuring opportunities

mazars

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Introduction

Against a backdrop of global competition and integrated markets, many businesses around the world are seeking growth opportunities outside their country of origin despite shifting, and at times complex, regulatory environments.

Pursuing transactions in Central and Eastern Europe (CEE) can present attractive prospects to investors, but it's important to understand that the acquisition and integration processes still respond to local specificities - even when the country in question is part of the European Union.

That is why we have published this study: to shed light on merger and acquisition tax risks and opportunities in CEE. The insight provided is based on our experts' experiences conducting due diligence tax structuring in the region and covers the tax risks they frequently encounter that threaten the success of the deal-making and subsequent integration processes in these fast-growing markets.

We take a broad approach to the CEE region and have included insight on the following EU and non-EU countries: Albania, Austria, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine. You will see that in our definition, we have included Austria as it is a strategically important country for CEE.

What we uncover is how the main 'tax traps' that appear in due diligence processes are related to thin capitalisation rules and the use of tax losses. However, these same transactions can also benefit from local tax incentives that support investments and exist alongside tax exemptions applicable to mergers and demergers.

Our expert guidance to navigate tax traps, incentives and exemptions revolves around a business enlarging its due diligence scope and conducting work on the ground in partnership with local advisors.

Methodology

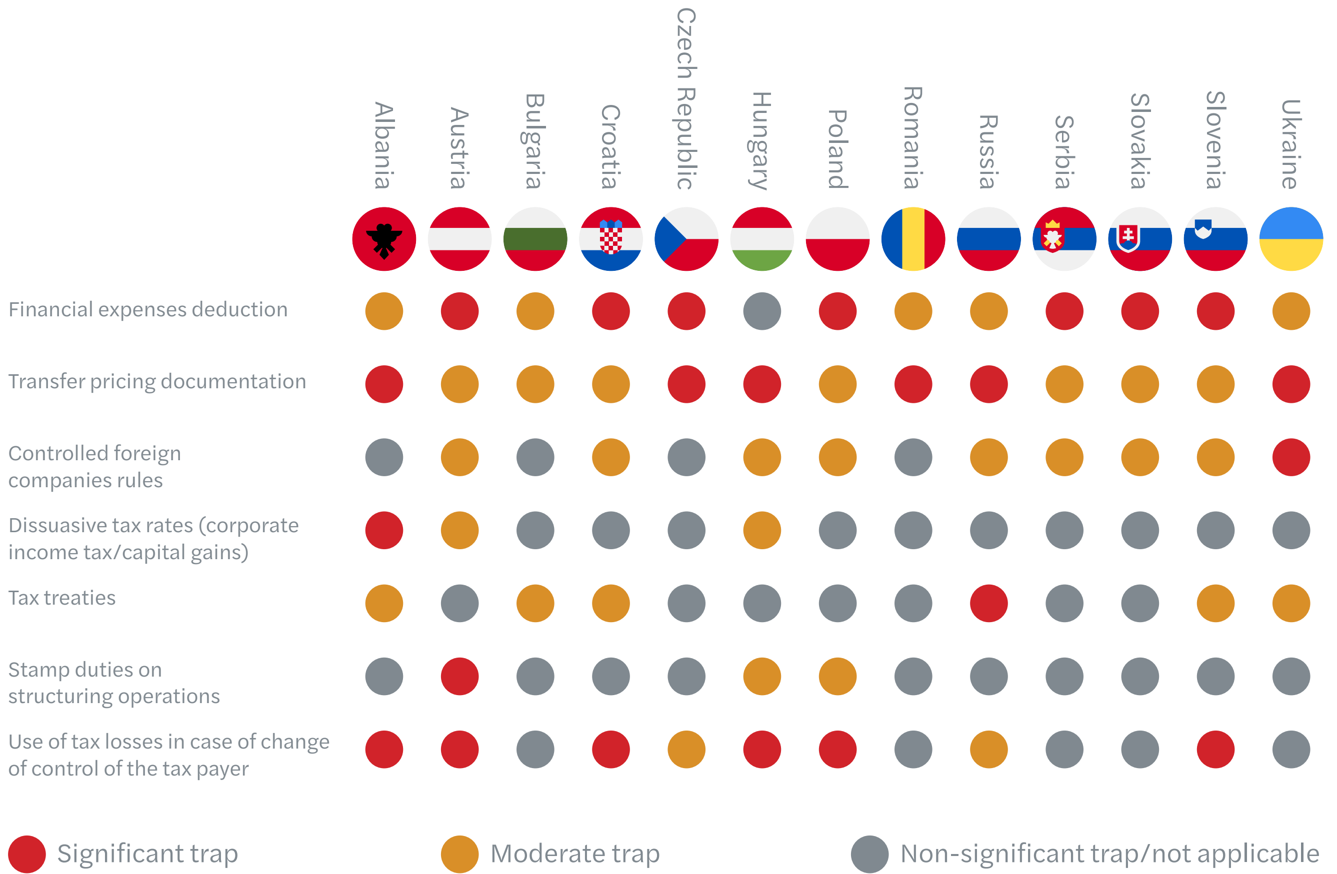
This study is aimed at providing guidance to investors as they navigate the tax traps, incentives and exemptions that occur when undertaking acquisition activity in CEE. To do that, we have created a study that focuses on the main traps, incentives and exemptions encountered in due diligence and tax optimisation processes when dealing with overseas acquisitions. In this study, our CEE experts based in the region share their insight and advice on how to deal with these tax matters, including their root causes and consequences.

The Mazars experts that have contributed to this study are based in 13 CEE countries: Albania, Austria, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine.

Colour coding in the study should be interpreted as signalling the likelihood of an occurrence. For instance, red implies a high likelihood of encountering a certain matter, while yellow indicates a moderate likelihood. Grey indicates the matter is not considered prevalent in that country, although this does not mean it will never occur.

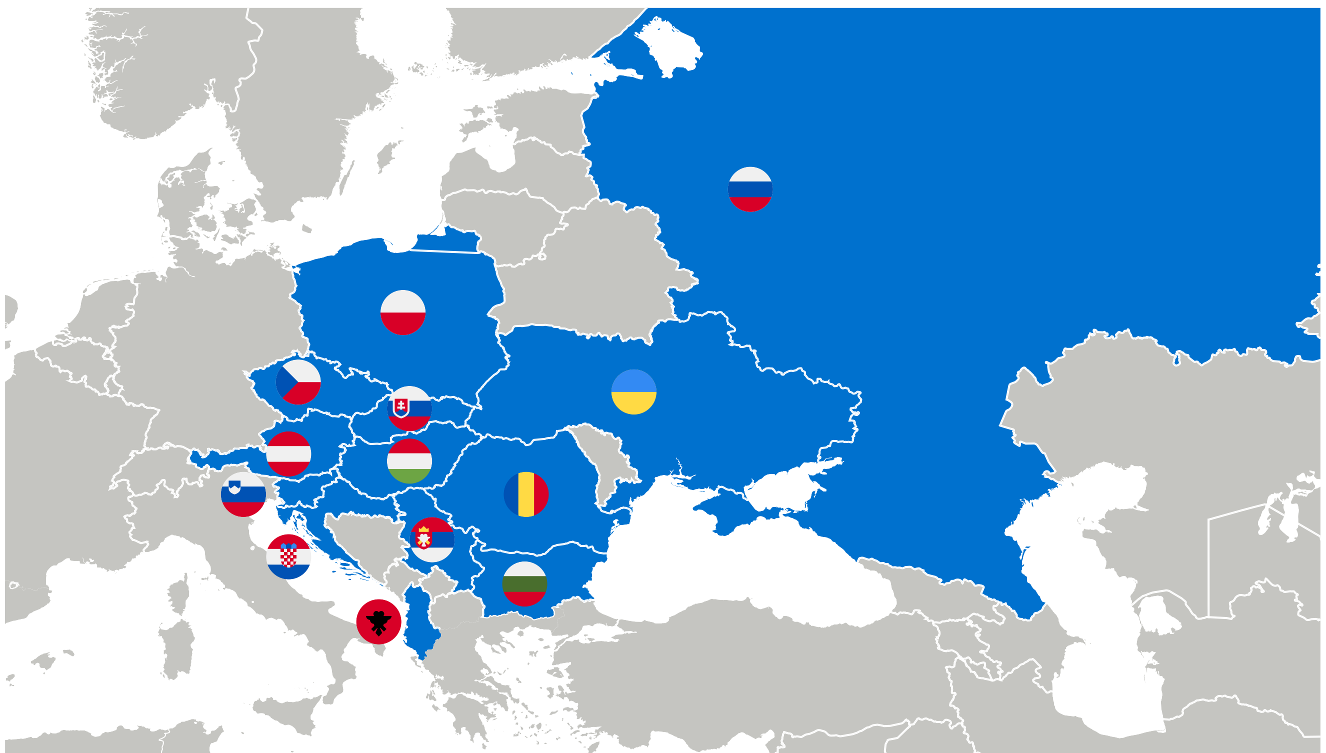
Date of publication: November 2020

Top tax traps



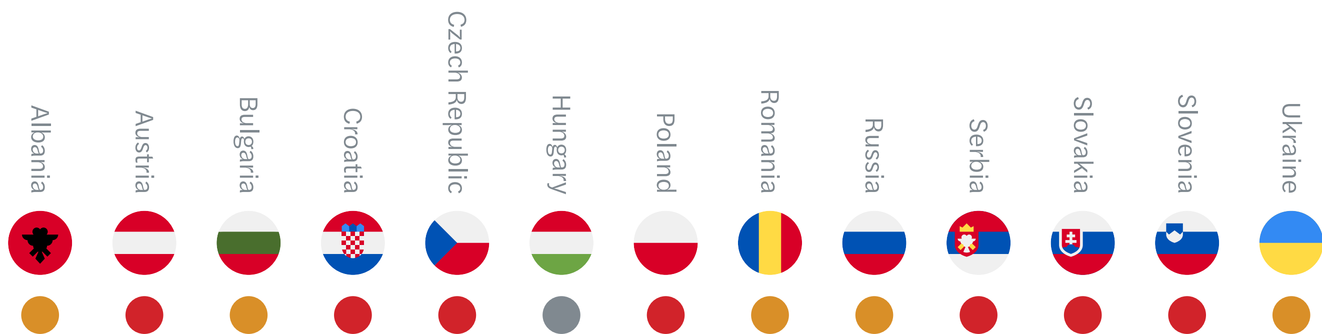
	Albania	Austria	Bulgaria	Croatia	Czech Republic	Hungary	Poland	Romania	Russia	Serbia	Slovakia	Slovenia	Ukraine
Financial expenses deduction	Moderate	Significant	Moderate	Significant	Significant	Non-significant	Significant	Moderate	Moderate	Significant	Significant	Significant	Moderate
Transfer pricing documentation	Significant	Moderate	Moderate	Moderate	Significant	Significant	Moderate	Significant	Significant	Moderate	Moderate	Moderate	Significant
Controlled foreign companies rules	Non-significant	Moderate	Non-significant	Moderate	Non-significant	Moderate	Moderate	Non-significant	Moderate	Moderate	Moderate	Moderate	Significant
Dissuasive tax rates (corporate income tax/capital gains)	Significant	Moderate	Non-significant	Non-significant	Non-significant	Moderate	Non-significant	Non-significant	Non-significant	Non-significant	Non-significant	Non-significant	Non-significant
Tax treaties	Moderate	Non-significant	Moderate	Moderate	Non-significant	Non-significant	Non-significant	Non-significant	Significant	Non-significant	Non-significant	Moderate	Moderate
Stamp duties on structuring operations	Non-significant	Significant	Non-significant	Non-significant	Non-significant	Moderate	Moderate	Non-significant	Non-significant	Non-significant	Non-significant	Non-significant	Non-significant
Use of tax losses in case of change of control of the tax payer	Significant	Significant	Non-significant	Significant	Moderate	Significant	Significant	Non-significant	Moderate	Non-significant	Non-significant	Significant	Non-significant

Significant trap | Moderate trap | Non-significant trap/not applicable



Top tax traps

Financial expenses deduction



Nature

The equity available to a corporate taxpayer corresponds to the only 'free' resource enabling the coverage of any company's liability towards its creditors, who bear the solvency risk of the company. Therefore, local tax provisions most often regulate the proportion of financing of the corporate taxpayer through equity and debt. Such provisions aim at solving solvency issues borne by the company's creditors as well as at limiting the possibility of abuses through excessive interest deductions. In addition, ATAD has been implemented in EU countries and financial expenses deduction see new limitations applicable on top of thin-capitalisation rules.

Impact

Financial expenses deduction rules determine the proportion of financial expenses actually incurred by the corporate taxpayer that can be considered as deductible for corporate income tax (CIT) purposes. The amount of interest paid in excess of the limits is not tax deductible.

Solutions

Companies must monitor the level of their debt and financial expenses in order to achieve a full deduction of their financial expenses.

Illustrations

Bulgaria

Generally, the thin capitalisation rules (limiting the amount of interest expenses) is applied in cases when the average amount of the attracted capital (interest-bearing debt) is more than three times the average amount of the equity of the company of the tax year.

Czech Republic

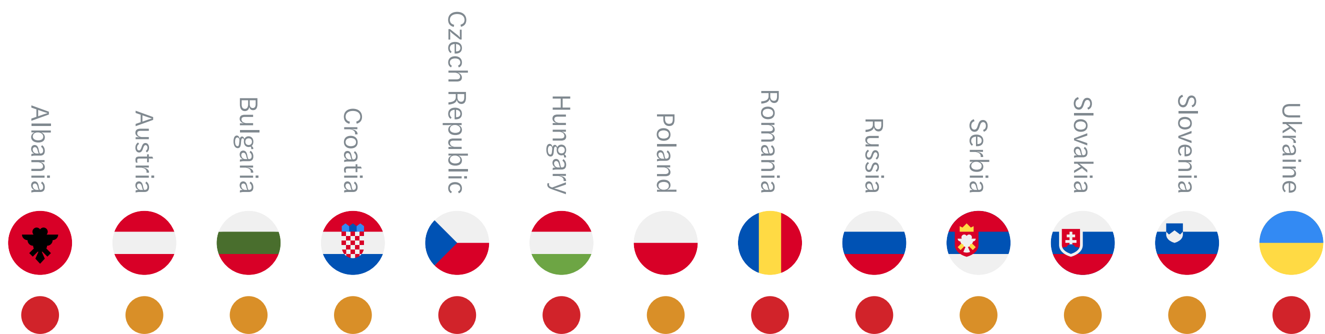
Tax deductibility of financial expenses on loans received from related parties is limited to the extent that the loan principals do not exceed four times (or six times in case of banks) the company's equity. The thin capitalisation rules do not apply to interest free loans or loans where interest is capitalised in the value of fixed assets (e.g. during the construction phase). Financial expenses arising from loans where interest, yield or maturity are entirely or partly derived from the taxpayer's profit are tax non-deductible. In addition, ATAD rules generally limit the deduction of net financial costs (i.e. cost minus income; including costs capitalized in the value of fixed assets), without distinction as to the origin of the debt (so both related and unrelated party), to 30% of the taxpayer's 'tax EBITDA', although it permits full deduction of net interest costs up to a threshold of EUR 3 million. Further, all costs related to shareholding of parent company in a subsidiary, including financial expenses, are not tax deductible

Slovakia

In Slovakia interest and other expenses related to loans received from a related party exceeding 25% of an amount corresponding to adjusted EBITDA (net income before taxes increased by interest expenses and amortisation) are non-deductible for tax purposes. This limitation does not apply in case of bonds. In addition, a restriction of tax deductibility of the interest on acquisition loans does apply in Slovakia. These interests are tax deductible only once the shares are sold and only subject to not applying the participation exemption on the capital gain from the sale of the shares. As a result, proper structuring is required if debt push-down is to be achieved.

Top tax traps

Transfer pricing documentation



Nature

Intercompany prices are sometimes used to relocate the companies' tax basis in a favourable tax jurisdiction in order to optimise the amount of corporate income tax. Therefore, in most countries, the local tax authorities have adopted the 'arm's length principle' implemented at the OECD, which stipulates that transactions between related parties should be carried out under the same conditions, notably in terms of pricing, as those that would have been agreed to between third parties. The companies must be capable of proving that the intra-group transaction they are involved in meets the arm's length criteria and must be able to justify, based on a sound documentation, that the price or the corresponding allocation of income, assets and/or equity (when recorded in respect of a branch) at stake duly reflects the situation of a non-related party under similar circumstances ('transfer pricing documentation'). In such contexts, the terms 'transfer pricing' refer to the setting, analysis, documentation, and adjustment of prices between related parties (for goods, services, or use of property, including intangible property).

Impact

Transfer pricing rules may vary from one country to another and may require, in certain cases, having an updated transfer pricing documentation available at the level of the corporate taxpayer to support all inter-company transactions. In practice, the fraction of inter-company expenses exceeding the level of similar expenses incurred at arm's length is added back to the corporate taxpayer's income for corporate income tax purposes. Similarly, indirect subsidies resulting from prices set below arm's length terms may be disallowed for corporate income tax purposes at the level of the corporate taxpayer. Lastly, in certain cases (e.g. lack of transfer pricing documentation), additional penalties may apply. Note, however, that tax treaties may provide for the possibility of benefiting from symmetrical corrections of local transfer pricing reassessments in the framework of a mutual agreement procedure (art. 25 of OECD model).

Solutions

Companies must meet the arm's length principle to avoid the tax risks of transfer pricing. Proper documentation should be available to justify the transfer pricing policy applied.

Illustrations

Albania

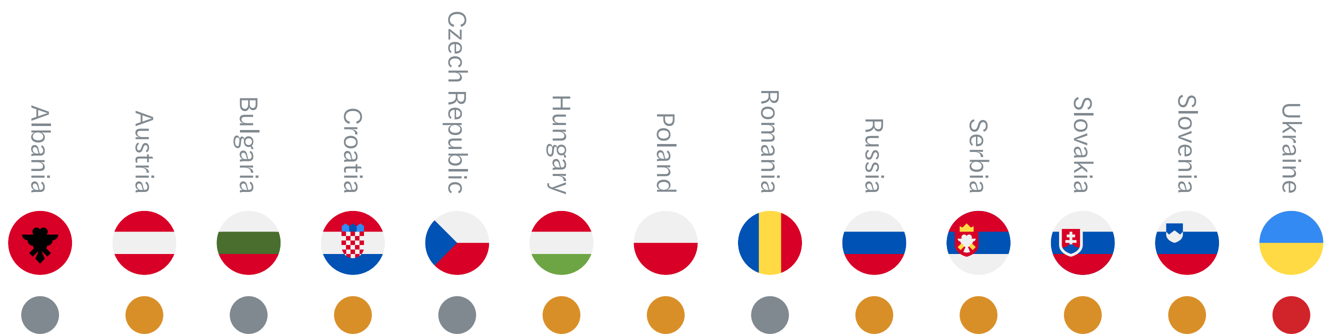
The law on transfer pricing in Albania consists on the following: the general rule provides the application of the arm's-length principle. The taxpayer is subject to transfer pricing rules if the taxpayer performs controlled transactions with its related parties where: (i) controlled transactions are considered the cross-border transactions only, (ii) the concept of related parties refers to the situations where one person participates, directly or indirectly, in the management, control, or capital of the other person, and (iii) the same person or persons participate(s), directly or indirectly, in the management, control or capital of both persons.

Romania

Although not a member of the OECD, Romania makes explicit reference to the OECD guidelines in its domestic tax legislation. However, the content of the documentation is mandated by domestic legislation, mainly that it must be prepared locally, and the comparability analysis must be performed firstly on the Romanian market. At this stage, the Romanian tax authorities have intensified their approach with respect to transfer pricing and we see more and more adjustment being imposed with respect to the prices used in inter-company transactions and charges.

Top tax traps

Controlled foreign companies' rules



Nature

Subsidiaries located in a jurisdiction where they benefit from a privileged tax regime (i.e. low taxation) are sometimes used to relocate their parent companies' tax basis in this favourable tax jurisdiction in order to optimise the amount of corporate income tax. Controlled Foreign Companies (CFC) rules aim at avoiding the use of low-taxed jurisdictions to shelter profits that would otherwise be taxed at a substantially higher rate.

Impact

CFC rules may vary from one country to another. A number of countries do not have such provisions/ rules. In most cases, the tax consequences of abusive use of those CFC consist in having the CFC income taxed at the level of the parent company.

Solutions

Companies should monitor the level of taxation locally and be able to prove the absence of abuse.

Illustrations

Croatia

Croatia has applied CFC rules since 1 January 2019. Per Croatian Corporate Income Tax legislation, a CFC is considered to be any entity in any organisational and legal form or a permanent establishment located in another Member State whose income is not subject to taxation or is non-taxable in that state. Nevertheless, such entity or a permanent establishment would be deemed a CFC of a Croatian taxpayer only if this taxpayer holds in it, alone or together with related parties, directly or indirectly, more than 50% of capital or voting rights or if it is entitled to more than 50% or profit of the deemed CFC. Additionally, another criteria that has to be met in order for it to be classified as a CFC of a Croatian taxpayer is that such entity or a permanent establishment has paid tax in this other State which is lower than the difference between the corporate income tax which would have been paid according to local Croatian legislation and the actual tax paid in this other state.

Russia

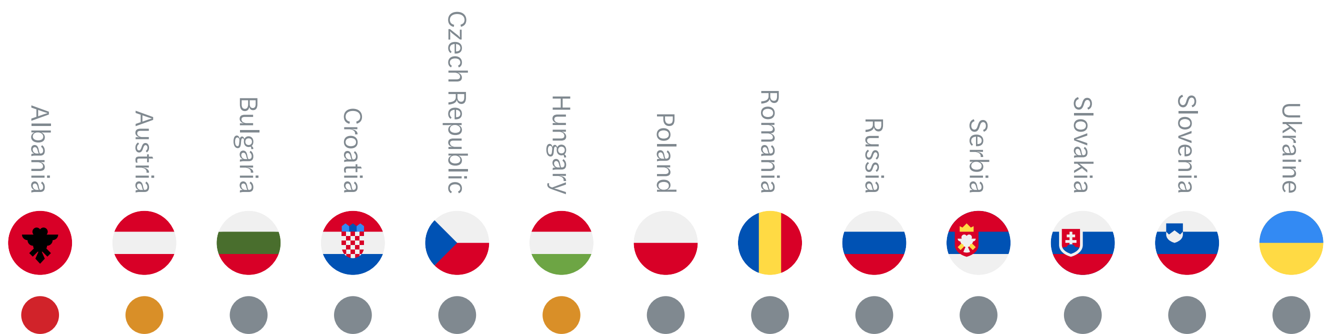
CFC rules may apply to subsidiaries with direct >25% participation of the Russian shareholder or >10% indirect participation of the specific Russian shareholder if overall indirect holding of all Russian shareholders is >50%. Moreover, a foreign company may be considered controlled even if the Russian tax resident holds no direct or indirect share but effectively manages the company.

Ukraine

In Ukraine CFC rules were just introduced in 2020 and will start to apply gradually from 2021 year. The controlling persons or entities will be UA-registered companies and UA tax resident individuals (not necessarily citizens). UA tax relief is granted if CFC is considered an 'active business' company or a company having proper business substance. Also, UA companies or individuals have an option to voluntary register a CFC as a Ukrainian tax resident taxable for UA-sourced income only, which gives relief from UA taxation of CFC's worldwide income.

Top tax traps

Dissuasive tax rate (corporate income tax/capital gains)



Nature

Capital gains tax rates may differ from local corporate tax income rates in order to limit the disposal of assets locally. This may be related to the nature of the assets at stake or to the way the assets are held (e.g. the vehicle through which the assets are owned).

Impact

Some applicable rates may discourage investors from selling their assets. Tax treaties should also be considered as they may provide reduced tax rates or exemptions

Solutions

Appropriate structuring may help minimise the tax impact, for instance through the disposal of the enterprise at a higher tier of the legal structure, enabling the taxable gain to be in a country where it is subject to a lower tax rate.

Illustration

Albania

Capital gains on the sale of shares are taxable at rate of 15%. The taxable base is the difference between the sale price and the purchase price of the shares (or the nominal value). The transfer of ownership of real estate, either land or buildings, is subject to 15% tax on the capital gain realised from the sale transaction.

Bulgaria

The capital gains or losses are excluded from the formation of the taxable financial result (valid to all companies except for the financial institutions).

Czech Republic

A capital gain resulting from the alienation of an asset is considered taxable income subject to CIT at 19% (tax residual value of the asset sold may be used as tax deductible expense).

Hungary

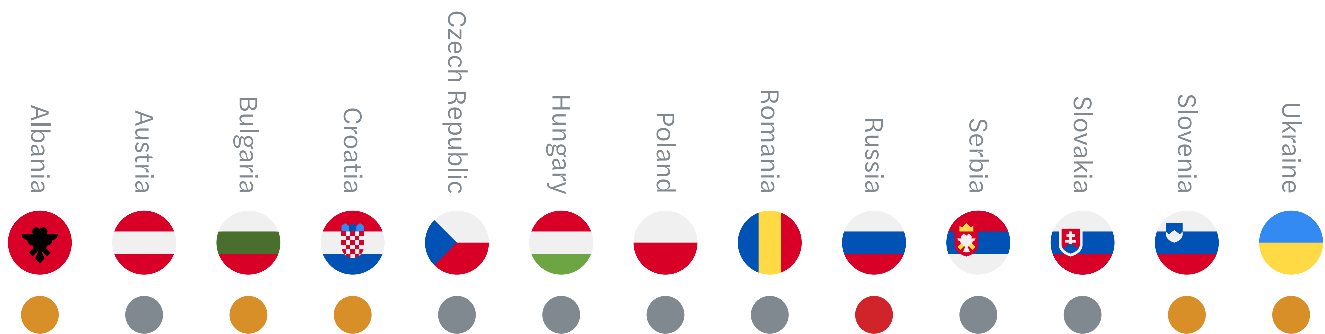
Capital gains are taxed as part of the accounting profit, at a rate of 9%, the same as the general corporate income tax rate. In addition, capital gains realised on the sale of shares by a shareholder resident in a foreign country (having no double taxation treaty, or DTT, with Hungary or having a DTT which allows the taxation of capital gains in the source state) are taxable if the shares are held in a Hungarian real estate holding company (meaning that more than 75% of the assets are composed of domestic real estate). In this case, gains are also taxable at a 9% rate.

Slovenia

There is no capital gains tax for companies in Slovenia. All types of income are taxed at the applicable corporate income tax rate through the annual corporate income tax return. Generally capital gains and losses may be set off against income and are taxed in the course of normal corporate taxation.

Top tax traps

Tax treaties



Nature

Since taxes aim to finance state budgets, they are generally set by governmental bodies and legislators that have jurisdiction over one country. Therefore, conflicting provisions from distinct countries may result in double taxation issues. To avoid such issues, states often enter into tax treaties that aim at avoiding double taxation. Tax treaties are drafted based on models issued either by the OECD and/or, more rarely, the United Nation. For example, France has signed a significant number of tax treaties with emerging countries. These treaties aim at limiting double taxation and facilitating economic exchange between different countries.

Impact

In practice, the provisions of the tax treaties considered allow two objectives to be achieved:

1. Avoidance of double taxation: double taxation is avoided either through exclusive taxation of the income measured in the state who is a member of the tax treaty or through granting tax credits that aim at neutralising the impact, at the level of the beneficiary of the income, of the taxes possibly withheld at source at the level of the taxpayer who generated the income.
2. Reduction of withholding tax rates: tax treaties often introduce specific reduced withholding tax rates applicable to certain types of income (e.g. dividends, interests and royalties).

Solutions

Proper tax structuring could improve tax leakage on repatriation of profits, notably through the re-routing of profits which may enable withholding tax savings

Illustrations

Croatia

There are numerous tax treaties in force between Croatia and other countries (66 as of today). Thanks to the tax treaties entered into by Croatia, and if certain rules are met (mostly minimum ownership stake) withholding tax rate on dividends may be reduced from 12% (local rate) down to 0%. On interest or royalties withholding tax may be reduced from 15% (local rate) to 0%. Please note that according to a recently published Draft Proposal of Amendments to Corporate Income Tax Act, a reduction of the tax rate for income from capital (dividends and profit share) from 12% to 10% is proposed (expected to come into force in January 2021).

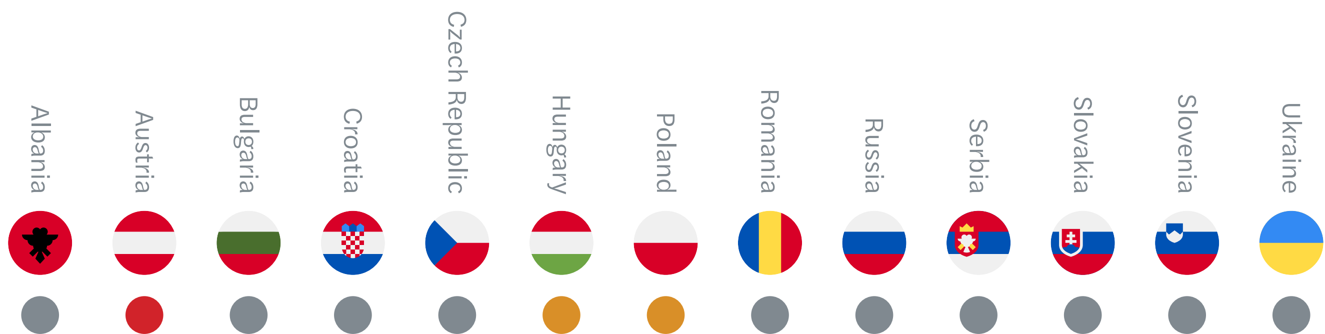
Russia

Generally, withholding tax rate on dividends may be reduced from 15% (local rate) down to 5-10%. An interest and royalties withholding tax rate can typically be reduced from 20% (local rate) to 0%. Application of the reduced withholding tax rates require for preparation of certain documentation, including confirmation of the recipient's beneficiary rights as well as careful consideration on the terms of the reduced rate applicability considering court practice.

Ukraine

Thanks to the tax treaties entered into by Ukraine, withholding tax rate on dividends may be reduced from 15% (local rate) down to 5% or (in some rare cases) to 0%. On interest, royalties or capital gains, withholding tax rate may be reduced from 15% (local rate) to 0%.

Top tax traps
Stamp duties on structuring questions



Nature

Where enforced, this tax is applied on the transfer of homes, buildings, copyrights, land, patents and securities. When this tax exists, the transfer of documents in locations is legally enforceable only when they are stamped, which proves the amount of tax paid. As they correspond in most cases to fixed amounts or relatively low costs, stamp duties are often seen as ancillary taxes. However, structuring transactions (asset deals, share deals, capital decreases, mergers) usually involve stamp duties depending on the laws of the countries. In certain cases, those costs may be substantial and could impact the carrying out of a transaction.

Impact

Stamp duties are an actual cost in transactions which has a direct cash effect at the level of the paying party. In certain countries, there exists a joint liability of both parties to a transaction for the payment of the stamp duties related to the transaction.

Solutions

In practice, companies should adopt the best routes that involve the most minimal stamp duty costs, either through the re-location of the transaction or the modification of the assets transferred.

Illustrations

Austria

The application of stamp duties was reduced, but they still exist in some cases. For example, the assignment of receivables, a hard parent company guarantee, or most rental agreements can trigger stamp duties. Certain mitigation strategies exist to avoid stamp duties.

Hungary

The rate of stamp duty (real estate transfer tax) in case of acquiring more than 75% of the shares in a domestic real estate holding company (meaning that more than 75% of the assets are composed of domestic real estate) is 4% up to HUF 1 billion, 2% for the part of the market value exceeding this, but not more than HUF 200 million.

Poland

There are no relevant stamp duties in Poland in the case of asset deal or share deal. Instead, tax on civil law transactions (TCLT) apply. By asset deal, sale of an enterprise or organised part of an enterprise is subject to TCLT on general principles, what means that the sale of each asset is subject to taxation at the rate of 1% or 2% of the market value depending on the type of asset. By share deal, the sale of shares is subject to TCLT at the rate of 1% of the market value on the shareholding rights.

Serbia

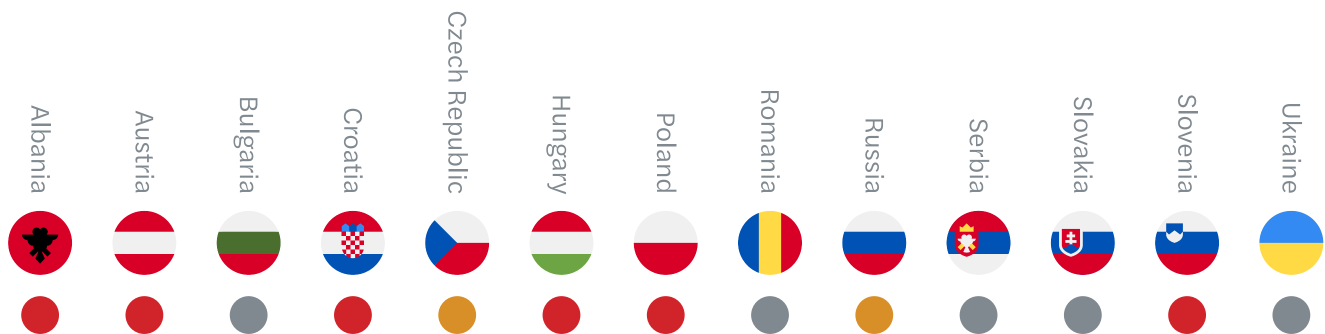
There are no stamp duties in Serbia.

Slovakia

Transfer tax is not applicable in Slovakia. Only minor administrative fees such as registration in the Commercial Register and verification of documents by notary public are payable.

Top tax traps

Use of tax losses in case of change of control of the taxpayer



Nature

For corporate income tax purposes, most states enable the offsetting of past tax losses carried forward against the taxable income of the year to enable the determination of the corporate taxpayer's corporate income tax basis. Therefore, existing tax losses may give rise to the recognition of deferred tax assets in the consolidated accounts, when it is likely that the losses will be used for offsetting tax purposes. In order to limit the abusive use of tax loss carry-forwards by corporate taxpayers who did not generate the corresponding losses and to whom the tax attributes have been transferred, the change of control may trigger the forfeiture of tax losses or may limit their use.

Impact

The total or partial forfeiture of tax losses carried forward in case of a change of control could have a potential impact on cash flows (as the corporate income tax cash-out increases) and on deferred taxes. Please note that several countries have no restrictive legislation on this matter.

Solutions

It is very difficult in practice to avoid the forfeiture of tax losses in case of a control change, when the local tax provisions impose such forfeiture. In this case, the risk could be reduced by acquisition price adjustments considering the amount of tax attributes lost.

Illustrations

Austria

Losses carried forward can be carried forward indefinitely. The main exceptions are the purchase of a shell company or certain restructuring measures. These may cause the loss carry-forwards to be lost in the event of an overall significant change in the structures of a corporation.

Poland

No impact of change of control in case of share deal. In the case of a merger, the tax losses of the acquired company cannot be activated by the acquiring company. There is also no possibility to transfer any tax losses to be utilised in the case of an asset deal.

Romania

In Romania, the change of ownership/control does not impact the use of carry forward tax losses.

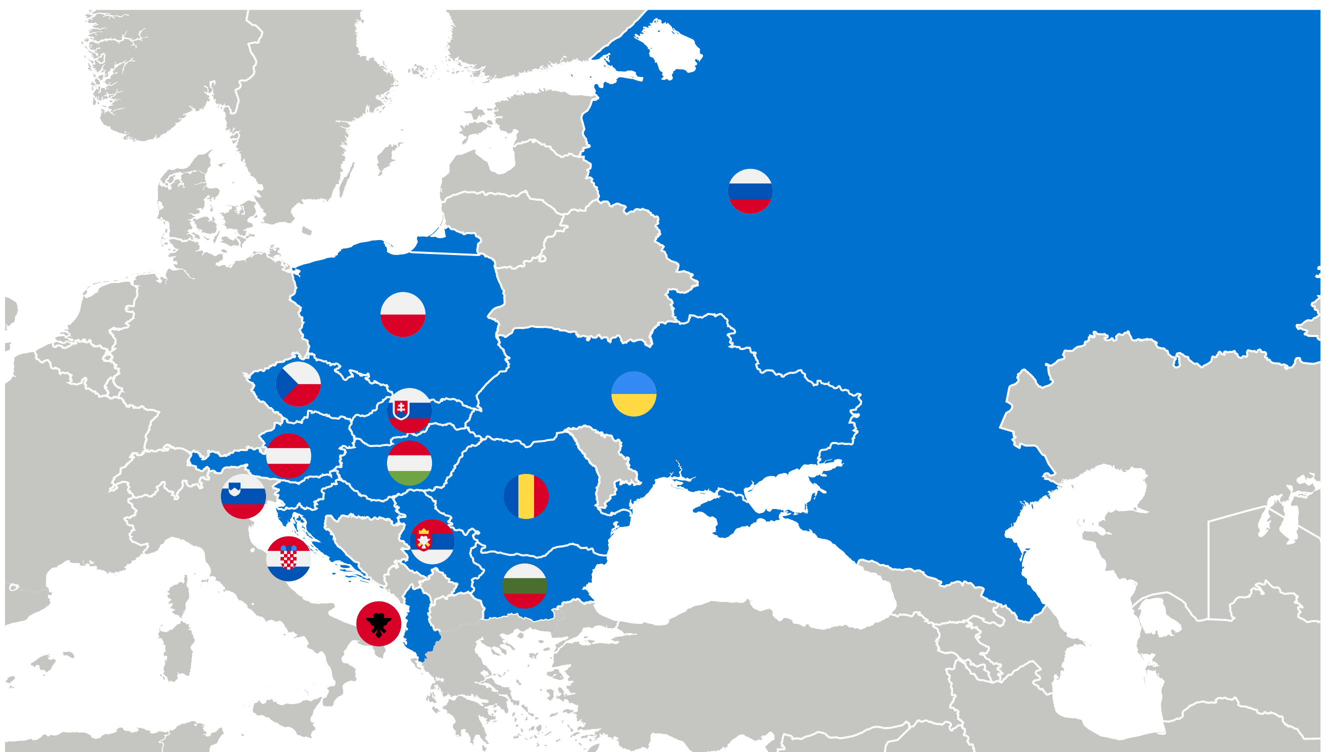
Slovenia

The use of retained tax losses is limited to a maximum of 63% of the actual tax base. Despite this limitation, tax losses may still be carried forward to subsequent years without a limitation, but loss carry backs are not permitted. Loss relief may not exceed the amount of current taxable income. Generally, losses that are generated in multiple tax years are absorbed chronologically. The right to carry losses forward may be forfeited if the ownership of the capital or voting power of the taxpayer claiming the loss carry forward changes by more than 50% within the tax period and the taxpayer either has not performed business activities for two years prior to the change of ownership or substantially changes its business activity two years prior to or after the change in ownership.

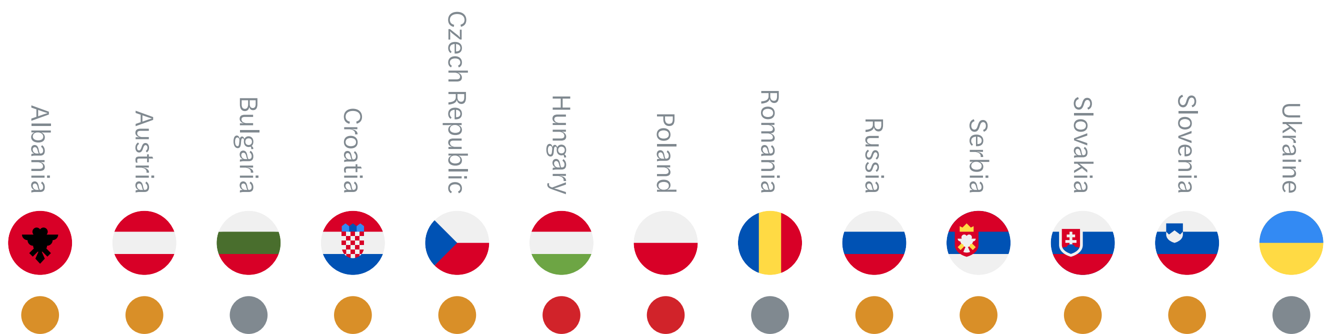
Top tax structuring opportunities

	Albania	Austria	Bulgaria	Croatia	Czech Republic	Hungary	Poland	Romania	Russia	Serbia	Slovakia	Slovenia	Ukraine
Amortisation of assets/Goodwill	Moderate	Moderate	Non-significant	Moderate	Moderate	Significant	Significant	Non-significant	Moderate	Moderate	Moderate	Moderate	Non-significant
Corporate income tax/capital gains trates	Significant	Moderate	Moderate	Non-significant	Non-significant	Significant	Non-significant	Non-significant	Moderate	Moderate	Moderate	Non-significant	Non-significant
Carry back/Carry forward of tax losses	Moderate	Moderate	Non-significant	Moderate	Significant	Moderate	Significant	Significant	Moderate	Non-significant	Significant	Non-significant	Significant
Tax treaties (tax sparing credits)	Significant	Moderate	Non-significant	Moderate	Non-significant	Non-significant	Non-significant	Moderate	Moderate	Non-significant	Non-significant	Significant	Moderate
Deduction of financial costs	Moderate	Moderate	Moderate	Moderate	Non-significant	Significant	Non-significant	Moderate	Moderate	Moderate	Non-significant	Moderate	Moderate
Group tax regime	Non-significant	Significant	Non-significant	Non-significant	Non-significant	Significant	Significant	Non-significant	Moderate	Non-significant	Non-significant	Non-significant	Non-significant
Tax exemption applied to mergers/demergers	Significant	Moderate	Non-significant	Significant	Moderate	Moderate	Moderate	Significant	Moderate	Significant	Non-significant	Significant	Non-significant
Local incentives supporting investments	Significant	Moderate	Moderate	Moderate	Moderate	Moderate	Significant	Moderate	Moderate	Significant	Significant	Moderate	Significant

Significant opportunity | Moderate opportunities | Non-significant opportunities/ not applicable



Top tax structuring opportunities
Amortisation of assets/goodwill



Nature

As a general principle, goodwill is an intangible asset which provides a competitive advantage, such as a strong brand, reputation, or high employee morale. In an acquisition or restructuring, goodwill appears on the balance sheet of the acquirer in the amount by which the purchase price (or transfer value) exceeds the net tangible assets of the acquired business/company. In such a context, this amount is considered as representing the synergies between the existing business and the acquired/transferred business, either in the form of cost reductions and/or revenue enhancement. The recognition of such goodwill is sometimes supplemented by the possibility to amortise such goodwill from an accounting standpoint and, in some countries, from a tax standpoint, in order to reflect that a part of the price paid at the moment of acquisition, corresponds to future profits of the business transferred or acquired. Note that the amortisation of goodwill and intangible assets for tax purposes is not systematically allowed.

Benefits

Where possible, the goodwill (market share, opportunities, etc.) and intangible assets (patents, software, etc.) may gradually be amortised using a straight-line method. Amortising those assets may lead to significant tax cost reductions.

Optimisation process

Accordingly, companies should carry out further studies about the feasibility and the domestic tax treatment with respect to amortisation.

Illustrations

Hungary

Under the current regulation, goodwill can only be recognised in the event of a business transfer. From an accounting point of view, it should be indicated as an asset in the balance sheet. For accounting purposes, an amortisation period of 5-10 years can be planned. However, for corporate income tax purposes, 10% depreciation is applicable.

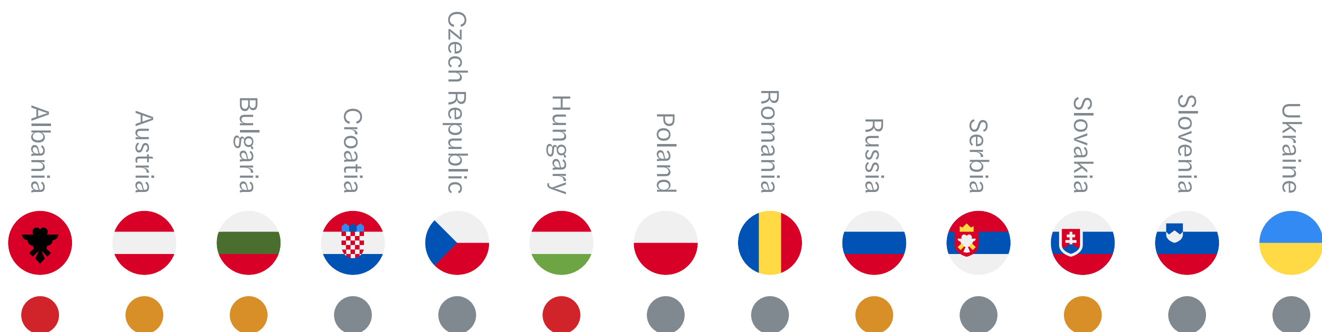
Poland

By asset deal, the acquisition of an enterprise or organised part of an enterprise might create a goodwill (surplus of purchase price over assets value) which is subject to tax amortisation. In case of asset deal there is no goodwill for tax purposes to be recognised.

Russia

Depreciation of tangible assets in certain cases may significantly reduce profits tax due (such as in case of accelerated depreciation). IPs' are generally subject to depreciation for the tax purposes, however, the goodwill as well as some specific assets (such as land) are not subject to depreciation.

Top tax structuring opportunities
Corporate income tax/capital gains rates



Nature

The profits derived from a corporate taxpayer's day-to-day activities as well as the gains resulting from the disposal of its assets are generally subject either to CIT under standard rules or to capital gains tax, the rate of which often varies depending on the nature of the assets disposed. In several cases, reduced tax rates may be set up by local tax authorities and used as incentives to corporate taxpayers. Please also note that most tax treaties aiming to avoid double taxation also set forth reduced tax rates (mainly for withholding tax purposes) which may enable tax savings upon proof of the tax residency of the taxpayers on each end of the financial flow.

Benefits

Some applicable rates may encourage investments.

Optimisation process

An appropriate structuring could improve the utilisation of these incentives, notably through proper routing of the financial flows of income.

Illustrations

Albania

The corporate income tax (CIT) rate in Albania is 15%. CIT is assessed on the taxable profits calculated as taxable income minus deductible expenses. As of January 2021, companies with turnover up to 14 million Albanian lek (ALL) are expected to be exempted from CIT.

Taxpayers with annual turnover up to ALL 5 million are exempt from CIT, whereas taxpayers with annual turnover from ALL 5 million to ALL 14 million are subject to a reduced CIT rate of 5%. Other taxpayers with annual turnover greater than ALL 14 million are subject to a 15% CIT rate. However, taxpayers whose activity is software production and development are subject to a 5% CIT. Similarly, taxpayers whose activity is based on agricultural co-operation and those whose activity is certified as 'agro tourism', in accordance with the respective laws, are subject to a 5% CIT. As of 2021, the threshold of CIT exemption will change, and the companies generating an annual turnover of less than ALL 14 million will be exempted from CIT. The standard CIT rate for companies generating an annual turnover more than ALL 14 million will be 15%.

Bulgaria

For non-financial enterprises, the capital gains or losses on financial instruments is not considered for tax purposes (i.e. it excluded from the basis for tax result formation). The above rule is not applicable for financial institutions, for which the capital gains/losses are treated with the standard CIT rate. The investment property gains or losses are also excluded from the formation of the tax result, and for tax purposes a straight line amortisation is applied.

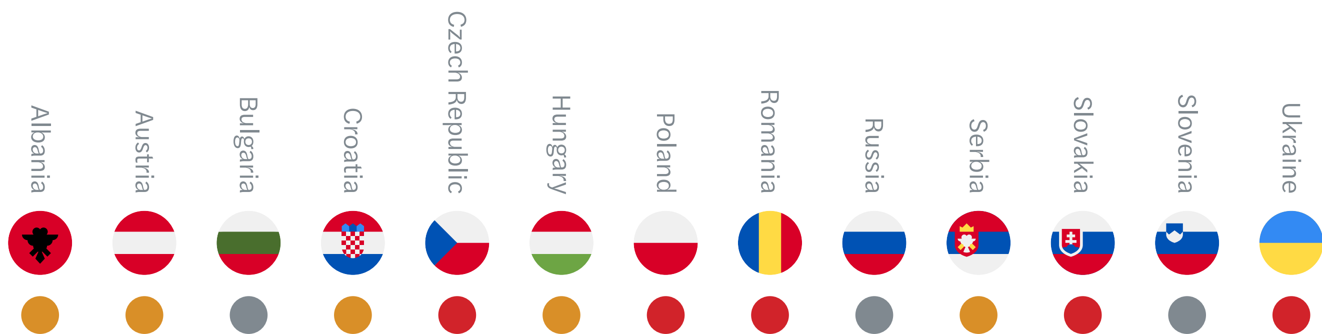
Slovakia

Capital gains tax rate is the same as the standard corporate income tax rate (21% or 15% if the total revenues of the company in the respective tax period are below TEUR 100).

However, participation exemption applies to income from alienation of shares if : (i) the minimum holding period is met 24 consecutive calendar months since the day when the 10% share was acquired, (ii) the minimum participation of 10% is held, and (iii) the holding company is able to demonstrate that it had the necessary personnel and material resources in Slovakia to perform substantial functions and to control and bear the risks associated with the ownership of the participation.

Top tax structuring opportunities

Carry back/carry forward of tax losses



Nature

For corporate income tax purposes, most states enable the carry-forward or the carry-back of past tax losses in order to offset them against the taxable income of either past years (carry-back) or subsequent years (carry-forward). Thus, the carry-forward and carry-back impacts the determination of the corporate taxpayer's corporate income tax basis. Therefore, existing tax losses may give rise to the recognition of deferred tax assets in the consolidated accounts if it can be evidenced that it is likely that, at year-end, the taxpayer will generate enough tax basis in the future to offset those tax assets. Carry forward is mainly adopted by emerging countries but not all countries allow carrying tax losses back.

Benefits

Both carry-back and carry-forward mechanisms allow some flexibility in the management of losses by corporate taxpayers. Also, having losses carried forward or carried back will impact the deferred tax in consolidated accounts.

Optimisation process

Companies should monitor the expiry of the tax losses in accordance with the provisions of their domestic tax law.

Illustrations

Romania

In Romania, the fiscal legislation allows only carry-forward of tax losses, for a period of seven years, for taxpayers registered for corporate income tax purposes. In case of a merger or spin-off, the absorbing entity, or the newly set up entity resulted from such reorganisation process, will take over the tax losses in a proportional amount. No carry-back of tax losses is allowed.

Serbia

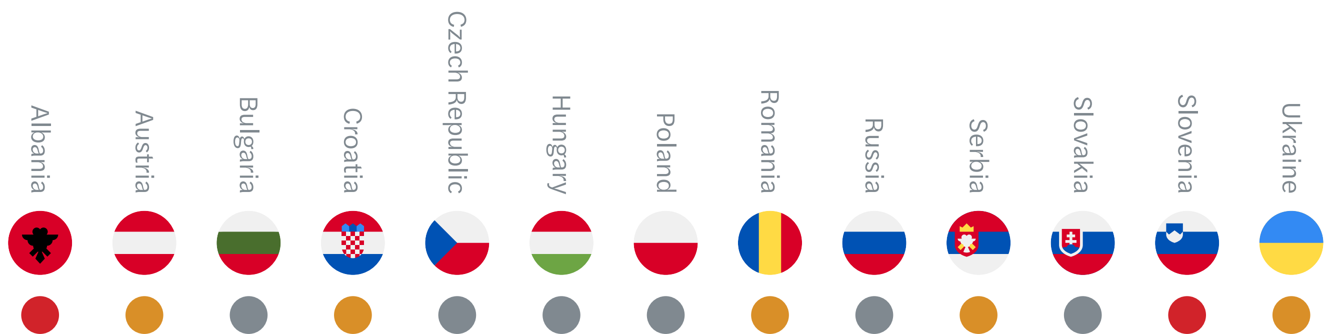
Losses can be carried forward five years and set off against taxable income. No carry-back is allowed. In the case of statutory changes, losses that were suffered by companies prior to the, e.g. merger that have not been utilised may be set off against the taxable income of the consolidated company after the merger.

Slovakia

Carry back of tax losses is not allowed in Slovakia. The tax losses may only be carried forward as follows: (i) for the period of four consecutive tax periods following the tax period in which the tax loss has been incurred, however only up to a quarter of the loss in a given tax period, (ii) for tax losses incurred in the tax periods beginning on 1 January 2020 and later, new conditions of utilisation apply. For example, such tax loss may be utilised up to five consecutive tax periods from the tax period in which the tax loss has been incurred, however, only up to 50% of the respective tax base in the given tax period.

In case of a merger or demerger of the company, it is possible to carry forward the losses to the legal successor provided the merger or demerger was not driven solely by tax purposes, i.e. to decrease or avoidance of the tax liability.

Top tax structuring opportunities
Tax treaties (tax sparing credits)



Nature

In some cases, the amount of tax credit necessary to avoid double taxation may be higher than the amount of the income tax that should be paid in the country where the income is originated. This results in a potential tax optimisation when the tax credit can be offset by the tax due at the level of the beneficiary of the income.

Benefits

Such mechanism increases the tax credit to be offset by the tax charge of the beneficiary of the income sourced abroad.

Optimisation process

Considering that the gain could be significant for a company that operates an entity in an emerging country benefiting from tax-sparing credits, companies should find a way to manage the tax credit offsetting at the level of the beneficiary.

Illustrations

Albania

The gross amount of interest and royalties paid to non-resident companies is subject to a 15% tax rate, while dividends and distribution of profits are taxed at a rate of 8%, unless a DTT provides a different rate. If a non-resident company does not create a permanent establishment in Albania, and a DTT exists between Albania and the home country of the non-resident company, no withholding tax payment may arise.

Croatia

The tax sparing credit provision can be found in the following DTTs: DTT with Finland (Article 22, paragraph 4a) but only with a temporal clause (five years with the possibility of extension), in DTT with Indonesia – only valid from Indonesian side (Article 22, paragraph 3), DTT with Qatar (Article 22, paragraph 2), DTT with Malaysia – only valid from Malaysian side (Article 23, paragraph 3) and DTT with Mauritius (Article 23, point 3).

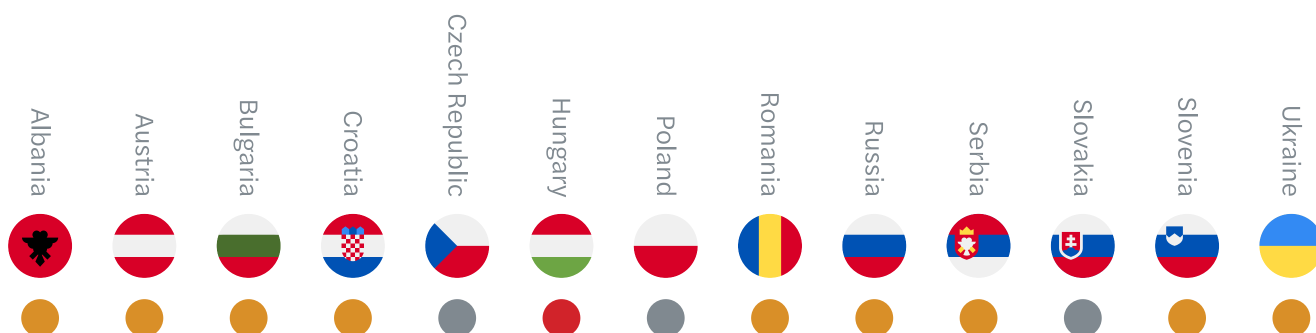
Romania

For Romania, generally the tax credit provided by bilateral tax treaties is limited to the tax computed according to domestic legislation, that would had been paid in Romania for such income. Therefore, no tax-sparing credit is available.

Slovenia

The taxable profit is imposed with a rate of 19% in Slovenia. Another method would be through credit, when the profit is taxed in Slovenia, but a credit is granted in the treaty country of origin of the company's owners. In order to benefit from the exemption, it is necessary to complete a standard form with the tax authorities in Slovenia. A new request must be issued for each payment of income. If the requester pays out taxes on profits regularly, it is possible for the tax authorities to approve the one-time submission of documents. Besides the corporate tax on profits, the withholding tax on dividends, interests and royalties receive certain exemptions or minimizations. The usual withholding tax on these is 15%

Top tax structuring opportunities
Deduction of financial costs



Nature

As a general rule, it is important to determine whether domestic tax law provisions put limitations to the tax deduction of financial expenses. Indeed, such restrictions may result either from thin capitalisation rules which aim to preserve the solvency of the corporate taxpayer at stake, or from specific provisions aiming to discourage a number of tax optimising structures considered abusive by the local tax authorities.

Benefits

The deduction of financial costs enables tax leveraging of investments abroad and more flexibility in the repatriation of profits.

Optimisation process

Companies should seek an improvement of the gearing between equity financing and debt financing and optimise the use of specific capital structures

Illustrations

Hungary

From 2019, the previous thin capitalisation rules have been replaced by the interest limitation rules set out by ATAD (30% of EBITDA or EUR 3 million).

Poland

Starting from 1st January 2018, Poland implemented completely new thin capitalisation rules based on ATAD. Currently, a general limit of tax-deductible costs of debt financing is in force, with a broad definition of 'costs of debt financing'. The new rules apply both to transactions between related and non-related parties. Limit of tax-deductible costs of debt financing depends on EBITDA of the company. Surplus of debt financing costs over revenues of similar nature exceeding 3 million PLN or 30% Tax EBITDA annually is non-deductible. Such surplus may be activated in the five subsequent years.

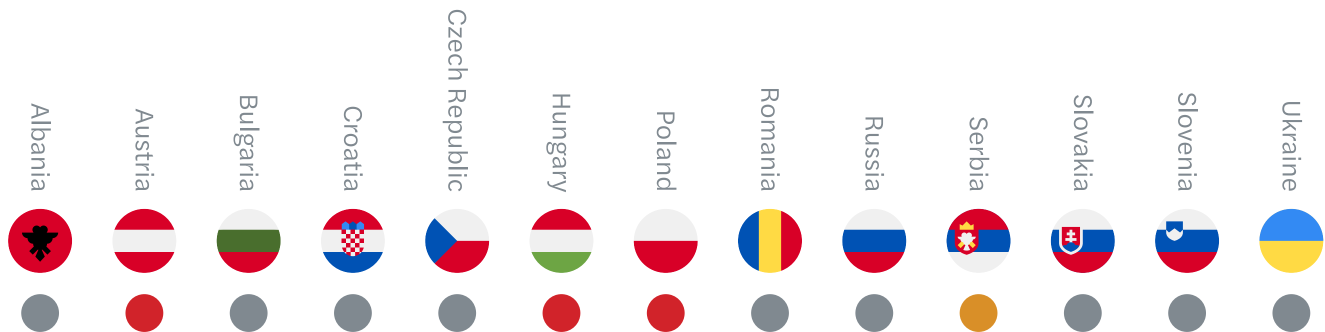
Russia

Russian thin capitalisation rules do not apply if debt to equity ratio is below 3:1 (for non-financial businesses). Due financial structure may allow for non-applicability of thin capitalisation rules and limitation of additional tax burden.

Ukraine

Unless thin capitalisation restrictions apply, deduction of any kind of interest is allowed.

Top tax structuring opportunities
Group tax regime



Nature

Specific incentives may apply to groups of companies (participation exemption, assessment of corporate income tax charges based on the aggregated income of the group members, etc.).

Benefits

The group tax regime enables a reduction of the tax basis through the offsetting of the losses incurred by tax group members by the profits earned by other tax group members.

Optimisation process

Proper structuring is sometimes needed to be eligible to participation exemption or tax group regimes.

Illustrations

Austria

The Austrian group taxation provides the opportunity to deduct losses of foreign group entities from the Austrian tax base. While a double dip is not possible, this still gives the opportunity to reduce the overall liquidity requirements for corporate income tax. A profit transfer agreement is not necessary; a financial connection (controlling interest) is sufficient. It is quite common to use the group taxation for the leveraged acquisition of targets, because then the interest for the loans can, in fact, be deducted from the target's profits.

Bulgaria

There is no specific tax regime or incentives that are applied to groups. The definition of a group is based on a consolidation of entities, in which a parent holding (or not) company may exert control over its operations.

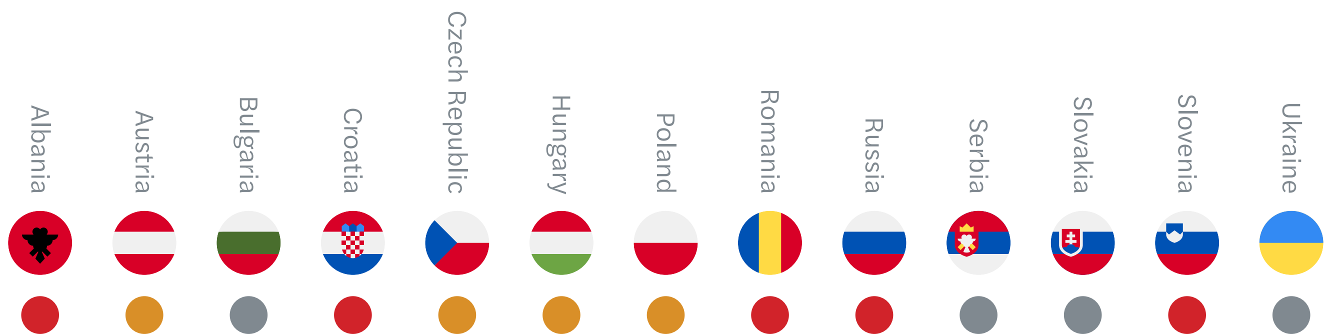
Hungary

As of 2019, group taxation is available in Hungary also for CIT purposes. This allows related parties to avoid some of the transfer pricing documentation obligation. Also, profit of group members can be set off against losses generated by other members of the group.

Poland

Poland introduced in its CIT law the concept of a 'tax capital group' formed by at least two capital companies (i.e. limited liability company or joint-stock company) which allows group CIT settlements. The agreement forming a capital group must be concluded for at least three years in the form of a notarial deed and must be registered by the head of a tax office. One of the companies in the group (a mother company) must have a direct 75% share in the share capital of other companies. Other conditions must be also fulfilled.

Top tax structuring opportunities
Tax exemption applied to mergers/demergers



Nature

In a number of countries, the tax impact of mergers, de-mergers and transfers of branches of activities may be neutralised (tax roll over) to the extent that a number of requirements are met.

Benefits

Companies are tax-exempt on the gain that may result from a merger, de-merger or assimilated transaction at the level of the absorbing company.

Optimisation process

Eligibility to such regimes should be carefully verified.

Illustrations

Croatia

In case of statutory changes (as per Croatian Companies' Act), there will be no CIT implications if the statutory change (transfer of business) is performed, in accordance with the accounting principles, at book values. Otherwise, if hidden reserves are realised, then CIT exemption may be sought via applying for Merger Directive.

Russia

Gains as of result of mergers and other form of restructurings are basically not subject to tax. Thus, re-structuring may be efficient instrument of consolidation or dividing of the group of companies. However, it is important that restructuring is driven by business and economic rather than by tax reasons. As an example, if a merger is conducted solely to ensure utilisation of historical tax loss with one of the companies, tax deduction of the respective loss is likely to be successfully challenged.

Slovenia

Slovenian Companies Act distinguishes among different types of M&A transactions: merger by absorption or by formation of a new company, and various types of divisions such as spin-offs, split-ups and split-offs; either by absorption or by formation of a new company.

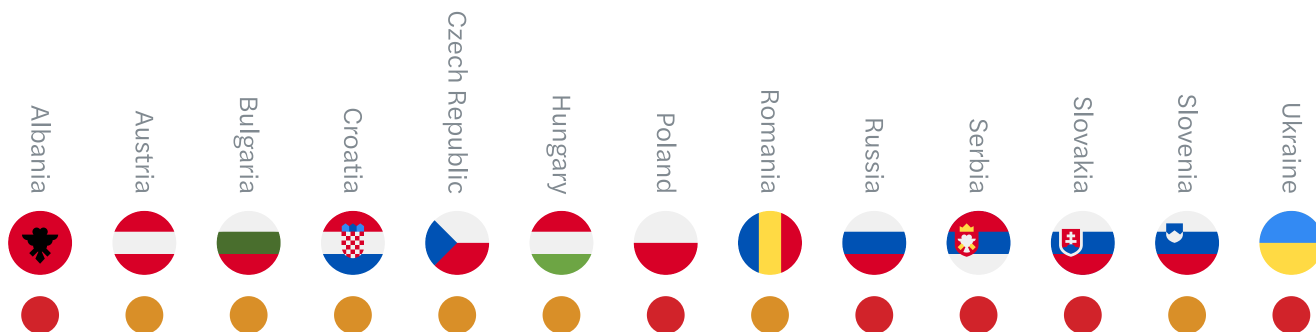
Pursuant to the provisions of Slovenian Corporate Income Tax Act (CITA) the transferring company is exempt from the tax relating to hidden reserves and/or profits. Additionally, losses that can be attributed to the transferred assets and liabilities are also exempt from taxation.

As a general rule, the receiving company assumes liability for the entire tax history of the transferring company. Thus, it could end up having to pay back taxes for the acquired entity, the amount of which could in practice be very significant. Consequently, tax due diligence needs to be carried out and should include not only the company's entire tax history but also inquiries about matters such as open audits and notices of audits. Pursuant to the provisions of Article 49 of the CITA, the receiving company is entitled to the following tax benefits: (i) the right to carry over provisions created by the transferring company and assume its rights and obligations related to these provisions, (ii) the right to take over tax losses of the transferring company and (iii) it is not liable to taxation relating to any gains accruing on the cancellation of its holding in the capital of the transferring company.

In addition, the receiving company as a universal successor may in practice also benefit from the use of tax incentives or tax reliefs of the transferred company.

Top tax structuring opportunities

Local incentives supporting investments



Nature

Local tax law may encourage the development of a sector of activity or of an undeveloped geographic area by granting various tax incentives (e.g. corporate income tax exemption or a lower tax rate).

Benefits

A company entitled to benefit from such incentives will reduce its tax burden. As a result, it will be able to expand its activity.

Optimisation process

Identification and eligibility to a specific tax incentive may sometimes be a driver for the location of the foreign establishment

Illustrations

Albania

Albania has implemented fiscal incentives within Economic Zones including the following measures: 50% reduction of profit tax for the first five years, entry and exit of goods according to the provisions of the Customs Code, deductible expenses 20% of the annual capital for the first three years, among others. In addition, specific measures apply to agriculture, accommodation structures and hotel and resorts which have four or five stars.

Austria

For investments into fixed assets started from August 2020 until February 2021, a tax credit amounting to 7%, for certain investments: 14% was recently introduced. This new rule is applicable in addition to the regular tax credit of 14% for all R&D costs (including related investments) according to the Frascati definition.

Serbia

A ten-year tax holiday is available for companies with a minimum investment in property, plant, and equipment of RSD 1 billion. To qualify for the credit, a taxpayer must employ at least 100 new workers for an indefinite period. The tax holiday is available for the ten-year period in proportion to the investment made. The number of employees employed in the tax period in which the taxpayer qualified for the tax holiday must be retained throughout the whole tax holiday period. Serbia has also implemented R&D, innovation and patent incentives.

Slovakia

In order to support the companies performing R&D activities in Slovakia, the Slovak tax system enables so called super-deduction of R&D costs. In addition, in 2018 Slovakia introduced the patent box regime, i.e. a special tax regime providing a tax exemption on 50% of income for granting the right to use, or for using the registered patents, utility models or software created by the taxpayer in Slovakia. A tax exemption is also applicable on 50% of profit from the sale of products for a production of which the registered patent or utility model created by the taxpayer in Slovakia was used.

Ukraine

There is a full corporate tax exemption until 2025 in Ukraine for aircraft building entities if they use saved funds for R&D, new technology or investment in new assets. A simplified tax regime is available for agriculture producers. Typically, full corporate tax exemption is granted to companies involved in large infrastructure projects financed by foreign financial institutions. There are a number of incentives allowing for accelerated amortisation allowance for certain fixed assets (such as automobiles, production equipment, cars and improvements to leased premises). Profits derived by investment funds are exempt from corporate income tax.

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