Tax aspects of the transfer of a real-estate development project

Asset Deal vs. Share Deal

Developers often consider, before making a decision, whether to transfer a project to a client by means of using an "asset deal" (i.e. a direct transfer of a real estate asset) or a "share deal" (i.e. an indirect transfer by way of the sale of a share/stocks in the company owning the asset).

In this article we will briefly outline the main differences and effects regarding the tax aspects of each of the transactions mentioned and we will likewise summarise both the advantages and disadvantages of the taxation of the said schemes from the perspectives of the developer and the purchaser of the project.

1. ASSET DEAL

In an Asset Deal the following taxes must be taken into account:

1.1 Real Property Tax

Real Property Tax is paid by a person who is the owner of real estate as at January 1 of the respective calendar year regardless of whether the owner transferred the asset later during the course of that year or not.

The amount of the tax levied is dependent on the region where the Asset Deal takes place and is determined by Slovakian towns and communes within the Generally Binding Rulings.

Real estate transfer tax has not applied in Slovakia since January 1, 2005.

1.2 Income tax

Income tax is paid from the "tax base", which is calculated as the difference between the taxable income of the developer earned from the sale of the real estate asset (i.e. the purchase price) and the tax expenses incurred in connection with the building of a construction and/or the acquisition of a land plot. The said difference will be taxed in the annual tax return.

It is important to note that if a developer incurs a loss in connection with the transfer of real property such a loss may be deducted from the tax base. This only applies, however, to losses from the transfer of buildings, whilst losses from the transfer of land plots are excluded from this principle.

1.3 VAT

Pursuant to the VAT Act, the supply of real property is considered as a supply of goods during which an ownership right is exchanged.

Generally, the following principle applies to a VAT taxation of the supply of real estate: (i) the supply of buildings is taxable and (ii) the supply of land plots is exempted from VAT. However, certain exceptions from the said principle apply.

First, the supply of "older" buildings is not liable to VAT. Pursuant to the VAT Act, the supply of a construction or its part is exempted from VAT provided that the supply is made five years after the first Use Permit *("kolaudačné rozhodnutie")* is issued. However, the taxpayer may choose to apply VAT to transfers of such "older" buildings.

The second exception pertains to land plots, as the transfer of building land is taxable. Furthermore, if building land upon which a building is constructed is transferred, the VAT taxation of the land plot follows that applicable to the transfer of a building.

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2. SHARE DEAL

In a Share Deal, the transfer of a real estate asset is not realized directly by the transfer of the ownership right to the said asset, but indirectly, through the acquisition of the share or stock in the company which is the owner of the real estate asset.

In practise, it is the parent company of the owner of the asset (and not the owner itself) which enters into contractual relations with the client (purchaser) and the object of the transfer is either a share (in the case of a limited liability company) or a stock (in the case of a joint-stock company) (shares and stocks will hereinafter be collectively referred to as "shares").

Since it is not rare for a parent company transferring the shares to be a company with its seat outside Slovakia, it is also worth mentioning the tax implications of such transfers for foreign companies.

2.1 Income tax

a) Parent company transferring an stock or share is seated in Slovakia

The "tax base" is calculated as the difference between the taxable income of the parent company earned from the sale of a share (i.e. the purchase price) and the tax expenses incurred with the acquisition of share (the amount of the paid-up capital or the acquisition price of the share).

However, in contrast to an Asset Deal, any eventual loss incurred from the transfer of a share cannot be deducted from the tax base of the company which sold share.

We point out that there is one significant difference between the transfer of a share in limited liability company and the transfer of a stock in a joint-stock company. Should the parent company transfer shares in more limited liability companies during the taxation period, such transfers will have to be measured individually. **In practise this means that** if the parent company gains a profit from the transfer of a share in one company and, at the same time, incurs losses from the transfer of a share in another company, it cannot compensate the said results of such transfers and must treat each transfer separately. On the other hand, the losses incurred and profits gained from the transfer of stocks in joint-stock companies during the taxable period may be compensated by each other.

b) Parent company transferring a share is seated outside Slovakia

First, it is to be noted that Slovak tax law will be applicable only in cases where the purchaser of the shares is a Slovak tax resident. Provided that both the seller and the purchaser are not Slovak tax residents, Slovak tax law will not apply.

If Slovak tax law is applicable then income which the parent company receives from the sale of the shares is considered as income having its source in the Slovak Republic. Such income may but need not be taxable in Slovakia.

To determine whether or not such income will be subject to tax in Slovakia the wording of the Double Taxation Treaty concluded between Slovakia and the country in which the parent company is a tax resident shall be decisive.

In this regard, the following alternatives may occur:

First, the income will not be taxable in Slovakia if the Double Taxation Treaty provides that such income may be taxable only in the country where the seat of the parent company is. Such a provision is included in the majority of Double Taxation Treaties.

On the other hand, the Double Taxation Treaty may state that the respective income may be subject to taxation in Slovakia. In such a case, the purchaser will withhold a certain percentage as stipulated by the Treaty of the price to be paid to the parent company and will pay this amount to the relevant tax office (the so-called "tax securing"). The parent company then receives the price of the shares decreased by the secured tax, submits annual income tax return in Slovakia and settles its tax obligation in Slovakia (i.e. it pays the full amount of Slovakian tax to set-off the tax already paid by the purchaser).

Nevertheless, it is important to point out that the final taxation of this income will be executed in the country where the worldwide income of the parent company is taxed at the tax rate applicable in the respective country. In practise, the tax that was paid in Slovakia will either be set-off (credited) against the total tax liability of the parent company or the income will be exempt from its total tax base.

This latter principle will also apply to cases where no Double Taxation Treaty exists between Slovakia and the country in which the parent company is a tax resident.

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2.2 VAT

a) Parent company transferring the share is seated in Slovakia

The transfer of the shares in a company is considered as a financial service which is exempt from VAT with all the relevant consequences.

In particular, the parent company cannot deduct input VAT related to taxable supplies received in connection with the paying-up or acquisition of the shares in a developer company. Accordingly, the transfer of the shares will influence the level of the coefficient, by which the VAT recovery of certain purchases is proportionally reduced.

b) Parent company transferring the shares is seated outside Slovakia

Provided that the parent company is seated outside Slovakia, a reverse-charge system will apply. According to Slovak VAT Act, the tax obligation will be transferred to the purchaser. Therefore, the parent company is not obliged to register for VAT in Slovakia or to pay the tax in Slovakia.

As the transfer of the share is exempted from VAT in Slovakia, it will have no financial impacts on the purchaser.

Conclusion

Developers will generally prefer a Share Deal as it allows them to transfer the whole project and become free of any potential future obligations with respect to the company transferred. Furthermore, contrary to Asset Deal, the income earned from the transfer of the shares will be taxed only once, by the parent company.

In an asset purchase, developers may theoretically face the risk of double taxation. The reason is that the company owning the asset will first pay tax in Slovakia from the income earned from the sale of the asset and the parent company may then have to pay tax when the proceeds in a form of dividends are distributed to it. This risk however does not arise in countries where Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States applies (the dividends are not subject to tax in the EU).

On the other hand, the **purchaser** will usually prefer an Asset Deal as it purchases a certain concrete asset. In a Share Deal it faces a risk of inheriting any unknown obligations or liabilities of the company purchased.

From the point of view of taxation, the main disadvantage of a Share Deal for a purchaser is the fact that the purchase price of the share cannot be applied by the purchaser as a tax deductible expense immediately, but only in the future after the purchaser subsequently transfers the share to another person. Furthermore, when the purchaser buys the shares, the company owning the asset will continue depreciating the asset from the original tax base of the depreciable asset (i.e. a building). However, when the purchaser acquires the asset as such, the full purchase price of the asset may be depreciated and thereby additional deductions and tax savings for the purchaser in the future may be generated.

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