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Acquisition Deals: Focus On Sale Of Enterprise

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Recently, we have seen a growing number of acquisitions worldwide, as well as locally, that were accomplished through the sale of an enterprise, and not by means of the “classic” forms of share transfer or asset transfer.

Below, we highlight some of the main issues which distinguish an enterprise deal from a share or asset deal, and which represent key considerations for a seller or buyer when selecting between an enterprise transfer or a share or asset deal. In addition to these issues, foreign entrepreneurs often select the sale of an enterprise over other forms of acquisition due to tax or transactional advantages in the seller’s and/or purchaser’s home jurisdiction.

Sale of Enterprise under Slovak Law

Slovak law defines an enterprise as a set of tangible, intangible and personnel components used for the operation of a business. Under an agreement on the sale of an enterprise, the ownership title to all assets, rights and liabilities pertaining to the enterprise (including all rights and liabilities pertaining to business and labor contracts) are transferred from a seller to a buyer by operation of law. The seller’s creditors may challenge the sale of an enterprise if it clearly decreases the chances for collection of the enterprise’s debts.

A sale of an enterprise is often followed by the liquidation of the seller, which may occur no earlier than one year after the sale of the enterprise.

Income Tax

Profit realized on the sale of the enterprise is treated as taxable income for the seller and taxed at the standard 19% income tax rate for the tax period in which the agreement on the sale of the enterprise comes into effect.

If there is any difference between the real value of the assets and liabilities acquired as part of the enterprise and their purchase price, this difference will be accounted for as goodwill/badwill in the purchaser’s books and depreciated/accrued into revenues over a maximum of 5 years for accounting purposes.

Under the currently valid wording of the Slovak Income Tax Act, goodwill/badwill accounted for by the purchaser of the enterprise may not be included in its tax base; i.e., the depreciation charges of goodwill are not deductible for tax purposes, and similarly, badwill charges released into the accounting revenues are not regarded as taxable income. This fact may adversely impact the sale of enterprise structure, as it would involve an additional tax burden for the purchaser of the

enterprise in transactions where goodwill has a substantial value. The pending amendment to the Income Tax Act, which should be effective from January 1, 2006, should remove this “unfair” treatment, and goodwill/badwill should be depreciated/accrued into expenses/revenues over a maximum of 5 years for both accounting and tax purposes.

Value Added Tax (“VAT”)

Generally, the sale of a business is not subject to VAT. This does not apply if a purchaser is an entity that primarily supplies VAT-exempt goods and services (e.g., financial, insurance, sale and lease of real estate under certain circumstances). If the purchaser is not registered for VAT purposes in Slovakia, it would become a VAT payer upon the acquisition of the business or its part from a VAT-registered payer.

Sale of Enterprise v. Sale of Shares

The main difference between a share deal and an enterprise deal is that in an enterprise deal the buyer does not become a shareholder of the selling company and, therefore, does not acquire any rights and obligations pertaining to the shares of the selling company. Moreover, although a buyer of the enterprise by operation of law acquires title to all assets, rights and liabilities pertaining to the acquired enterprise, in principle, he does not automatically acquire the trade and certain other business licenses issued by state authorities to the selling entity.

Transfer of Tax Liability

In a share deal, tax liability remains with the purchased entity. In an enterprise deal, the law is not as clear with regard to this issue. The recent prevailing opinion is that tax liability does not pass with the purchased enterprise, but remains

with the selling company. The Commercial Code stipulates that all liabilities pertaining to the enterprise should be taken over by the purchaser. However, the Tax Administration Act specifically provides that any agreements under which tax liability would be transferred to a third party are not effective for the purposes of tax proceedings, unless specific legislation stipulates otherwise. The question is whether the Commercial Code is in fact “specific legislation,” and whether tax liability should be regarded as “pertaining to the enterprise.” There are two contradictory decisions of the Slovak Supreme Court. In the most recent of the two, the court ruled that tax liability is not transferred with the purchased enterprise, because tax liability is a liability of a private entity against a public authority and, as such, cannot be transferred by operation of the Slovak Commercial Code. The Czech Supreme Court has issued a similar decision based on the same principles.

Sale of Enterprise v. Sale of Assets/Liabilities

The main difference between an asset/liabilities transfer and an enterprise transfer is that, in the case of the sale of an enterprise, any assets or liabilities pertaining to the enterprise can be excluded. If you exclude a single asset or liability, a contemplated sale of an enterprise could be treated as a sale of assets/liabilities. Furthermore, in the case of an agreement on the sale of an enterprise, an exhaustive list of all of the transferred assets and/or liabilities must be drawn up. An asset/liability deal is administratively more complex and cumbersome. If an enterprise is being sold, the seller’s creditors do not need to approve the transfer of liabilities (the seller guarantees the performance of such liabilities by the purchaser). Such consent, however, is required in the sale of assets/liabilities.

Conclusion

As indicated above, many issues need to be considered in order to select the suitable structure for a transaction. Share deals are often used due to their simplicity and rapid implementation. If there are certain liabilities or other risks pertaining to the sold entity that the purchaser is not willing to undertake, an assets/liabilities deal or an enterprise deal is implemented. The sale of enterprise is also preferable when only one part of an enterprise, e.g., one division, is sold. In such a case, a share deal is unsuitable, and an assets/liabilities deal is more administratively demanding.

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