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# The Global Corporate Advisor

The Corporate Finance newsletter of Crowe Horwath International



Welcome to the February issue of The Global Corporate Advisor. From South Korea we have an update, and outlook for the year. The restructuring required due to shedding of non-essential assets of large conglomerates has impacted mergers and acquisitions and will continue to do so.

From Serbia, we examine public-private-partnerships as a means for private investors to access public infrastructure projects. The new legal framework, adopted a couple of years ago, makes this a thriving sector for business.

Collective investment funds are the focus of an article from Colombia. These funds have become attractive investment vehicles for both foreign and domestic investors because of the tax regime applicable to them.

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## Contact Us

The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA, at [peter.varley@crowecw.co.uk](mailto:peter.varley@crowecw.co.uk). Alternatively, please contact your local GCA team member to discuss your ideas.

## Inside This Issue:

Welcome	1
South Korea: Update and Outlook	2
Serbia – Investment Opportunities and PPP	3
Collective Investment Fund – Tax Treatment in Colombia	5

## South Korea: Update and Outlook

By EY Hwang, Seoul

A new chapter has opened for financial advisors in Korea. Most Korean conglomerates are currently experiencing a lack of growth drivers. In the wake of the recent recession, they have witnessed slowing down of profit growth. These factors have resulted in mergers and shedding of non-core businesses, with many units up for sale.

As these large business groups begin their restructuring efforts in earnest, the potential transaction volume in the M&A market in Korea is estimated at around 160 trillion won (US\$143 billion) in 2015. Assets classified as non-essential in the top 10 conglomerates are expected to be over 163 trillion won in 2015, according to Korea's regulator, the Financial Supervisory Service.

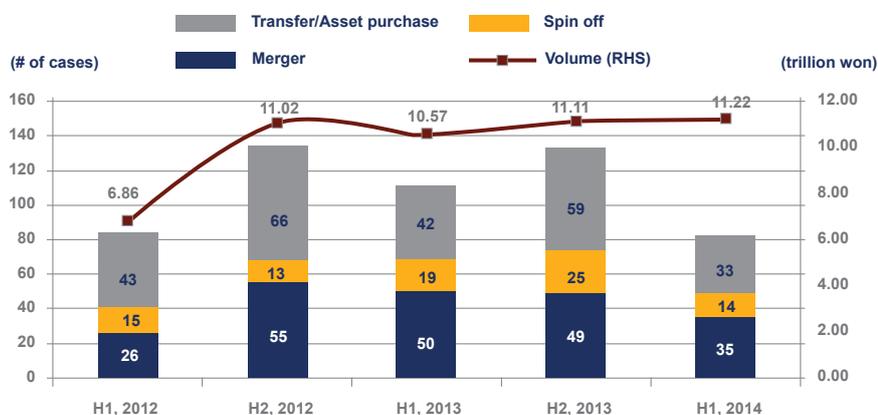
The Financial Supervisory Service has announced that the total aggregated deal volume of M&A activities in Korea was recorded at \$10 billion in H1 2014, primarily due to restructuring efforts by conglomerates. This represents the highest deal volume in Korean history.

Some investing banking experts are of the opinion that this is a rerun of the so-called refocusing process that happened among American companies back in the 1980s. Between 1981 and 1987, about half of the Fortune 500 companies in the US went through a refocusing process in the form of M&A and liquidation of non-essential units. It is predicted that a similar trend is in the offing in Korea.

Consequently, aggressive investment made by both local and foreign private equity funds (PEFs) in Korean companies has exceeded 15 trillion won (\$13.5 billion) in 2014. The number of M&As, in which private equity funds were the main buyers, reached 113 cases, with the total volume estimated at \$13 billion in 2014, excluding pure real estate transactions. Out of 11 mega M&A deals that were above \$50 million, there were only three deals in which PEFs were not involved. Furthermore, in the near future, the volume of total assets under PEF management that will come out for sale is estimated by the Korea Financial Investment Association (KOFIA) at over \$40 billion.

Therefore, it is reasonable to say that a new chapter has opened for financial advisors in Korea, with an ample volume of deals to keep them busy. Most notably, restructuring of conglomerates and PEF assets that are waiting to be released in the market will be the main drivers of Korean M&A market.

Figure 1



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## Serbia – Investment Opportunities and PPP

By Aleksandar Djordjevic, Belgrade

For many years, Serbia has been trying to stimulate its economy through all means possible. The government is putting in great efforts to provide a healthy and attractive environment by offering financial, tax and other incentives to attract investors to do business in Serbia. One of the outcomes of this endeavor was that in 2013 Etihad Airways acquired 49% of Jat Airways, Serbia's national flag carrier, receiving more than \$100 million in the form of subsidies for the following three years.

Starting a business in Serbia offers the opportunity for customs-free export into a market of one billion people. Not only does Serbia have a free-trade agreement with the EU, but it is the only country outside the Commonwealth of Independent States that is a part of free trade agreements with Russia, Turkey, EFTA, Belarus and Kazakhstan. In addition, Serbia is also a member of the Central European Free Trade Agreement (CEFTA), with a population of 29 million.

Upon completion of the ongoing negotiations with Egypt, Serbia will get a new duty-free territory for its products, adding more than 82 million people.

One of Serbia's strongest and key advantages is its labor force, which offers highly skilled technicians at a cost-effective price. Universities and colleges in Serbia produce around 47,000 graduates each year. Two-thirds come from technical universities and business related studies. Technical education is particularly strong, as Serbian high school students are among the best performers at world contests in natural sciences, while Serbian engineers are well-known for their expertise. Moreover, the Serbs are known for their high English language proficiency in Eastern Europe.

The tax regime in Serbia is highly conducive to doing business. Corporate income tax is among the lowest in Europe, while value added tax (VAT) is among the most competitive in Central and Eastern Europe. Corporate profit tax is paid at a uniform rate of 15%, whereas personal income tax is calculated at 10% of salary.

Since the beginning of the economic reforms, Serbia has developed into one of the leading investment locations in Central and Eastern Europe. As of January 2014, Serbia has officially started negotiations for an EU membership and has attracted investors such as Fiat, Microsoft, Bosch, Siemens, Michelin, Cooper Standard, Coca-Cola Hellenic Bottling, Delhaize, Gazprom and many others, who successfully run their businesses in Serbia.

To help the investment process and promote public companies in need of privatization, the Serbian government has established the Privatization Agency, which is responsible for organizing, implementing and controlling the processes of privatization. Since its foundation in 2001, the Privatization Agency is seen as a reliable partner during any part of the privatization process.

One of the methods adopted by the government for attracting foreign investments is the recent promotion of Public-Private Partnership (PPP) as a financing model for capital investments.

### What is PPP?

Public-Private Partnership is a concept of financing used by governments and local authorities (municipalities) to provide public infrastructure assets and services. There is no unique internationally recognized definition of PPP. However, the Public-Private Partner-

ships Reference Guide issued by the World Bank, Asian Development Bank, and Inter-American Development Bank observes that PPP is:

“A long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance.”

The PPP concept of financing is designed in mutual interests of both private and public sectors, for investments in public infrastructure, including roads, railways, government buildings, power generation, water and waste treatment facilities, and also the so-called social infrastructure, which includes schools, hospitals, and health services.

### Where is Serbia on PPP?

Since it grants access for private investors into public infrastructure, PPP may play a very important role for developing countries and economies in transition.

The Serbian government has been working intensively on the implementation of PPP projects for several years.

PPP involves several participating entities and succeeding in its implementation may be a complex task, which requires the governments to take numerous actions in order to create a favorable climate.

The Serbian legal framework that regulates the procedure for awarding public contracts is clearly defined in Law on PPP and Concessions, adopted in late 2011. In addition, the government formed a special body for implementation of PPP – the Commission for Public Private Partnership (the PPP Commission) in 2012.

The principle is that each participating entity in a PPP project should be sufficiently protected. Moreover, obligations for each party should be precisely defined. In that sense, an adequate legal and regulatory framework must be established. In addition, due to the long-term nature of infrastructure projects, legislature should be designed in a manner that amendments throughout the lifecycle of a PPP project are possible.

Different levels of authorities, governments and municipalities should coordinate to provide support and incentives for proper PPP implementation. The institutional framework should be established in order to back up PPP development, by ensuring the right investment climate and setting up a transparent and supportive regulatory system. The legal framework in Serbia goes toward providing for all this and developments in the pipeline promise to make the process even smoother.

Prior to the adoption of the new law, the cooperation between private and public sectors was regulated by the Law on Concessions, and therefore concessions were the only route for the private sector to access the public sector. However, due to the complex and time-consuming administrative procedure and lack of political will, the single contract signed under this law was the 30-years exploitation of minerals with Rio Tinto Group, a British-Australian multinational metals and mining corporation.

Many other negotiations failed, including the one to do with the Horgos-Pozega motorway concession project, which was supposed to connect western Serbia with the Hungarian border.

Adoption of new regulations and the forming of a PPP Commission have created a much more favorable environment.

The PPP Commission serves as a state body that promotes and helps interested parties enter PPP arrangements, and it is a key player in the Serbian market in this sector. The PPP Commission is obliged to assess each proposal for a potential arrangement. Its positive opinion on the proposed project is required in order to get a green light to continue with the procedure of public procurement.

Already, the PPP Commission has issued 18 positive opinions on submitted project proposals; however, only one contract has been signed so far. The signed contract is for the establishment of fiber-optic infrastructure in Novi Sad (the second largest city in Serbia), and the contract is between the local municipality and a consortium consisting of Slovenian companies Sago, E projekt and Riko, along with the British company, Emtelle and a Dutch company, Genexis. The total value of the project is €70 million. According to the deal, the consortium will finance 100% of the project and collect 75% of the earnings of fiber-optic network during the period of 25 years.

Other projects that have been given a positive opinion by the PPP Commission are still under the procedures of preparation or procurement.

Additionally, the government and the Autonomous Province of Vojvodina recently signed a cooperation protocol for the construction of the Novi Sad-Ruma motorway. This €180 million project could be implemented under a PPP arrangement.

## Conclusion

Taking into account the need for rapid infrastructure development in Serbia, particularly in the area of constructing new roads and railways and reconstructing existing ones, the popularity of PPP arrangements can be expected in coming years.

In June 2012, the PPP Commission became a member of the European PPP Expertise Centre (EPEC), which gathers PPP authorities from 39 states. Membership in EPEC is essential for creating the administrative capacities of the PPP Commission, as well as for sharing experiences of such arrangements with European countries.

However, in order to avoid some possible practical problems, further amendments in legislation are required, especially in terms of cutting some unnecessary administrative procedures. In addition, a Register of Public Contracts is expected in the near future, which will make all public operations more transparent, including PPP arrangements.

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## Collective Investment Fund – Tax Treatment in Colombia

By Jairo Higueta, Bibiana Buitrago and Andrés Pachón, Bogotá

Collective investment funds have become attractive vehicles through which local and foreign investors can execute their investments in Colombia because of, among other reasons, the tax regime applicable to them.

Despite their appeal, the structure and some of the special features granted to collective investment funds have been sometimes misunderstood by taxpayers and the Colombian Tax Authority. This may jeopardize the particular business structure of a collective investment fund. Therefore, appropriate tax advice on structuring such funds is desirable.

### Income tax regime

The income tax treatment for collective funds is contained in Law 49, 1990, which is incorporated in section 23-1 of the Colombian Tax Code.

The tax authority has ruled that section 23-1 of the Colombian Tax Code, and the income tax treatment set by it, is applicable to collective investment funds. Under the Tax Code, collective investment funds are not income tax payers.

Therefore, collective investment funds are not triggered with income tax or obliged to file income tax returns. Under article 23-1, collective investment funds must transfer to the investors of the fund the revenues under the same title as the fund has received them and under the same tax treatment as if the fund investors had received the revenues directly themselves. This constitutes the transparency principle for income tax purposes.

### Withholding tax

Section 369 of the Colombian Tax Code commands that payments made to non-income tax payers must not be subject to income tax withholding.

On the other hand, section 368-1 establishes that managers of collective investment funds must withhold income tax in accordance with the withholding tariff.

In this regard, collective investment funds, or companies that manage such funds, or financial institutions that make payments to investors, as set by the government, need to execute the withholding tax, which corresponds to the income distributed to subscribers or participants, at the time of payment.

When payment is made to a person not resident in the country, or to a foreign company, or to a person not domiciled in the country, the withholding tax will be considered income tax and will be applicable according to the special rules of payments abroad.

However, when the payment is made to a person resident in Colombia or to a Colombian company, the general rule should be followed. This means that the funds and collective portfolios are treated according to the rules specific to their investments – for example, if the fund invests in stock, the investor, through their shares, is also liable for taxation according to rules governing income from stocks, as if the income was directly received.

### Tax authority considerations: tax benefits and special treatments

In certain cases, the tax administration has understood that benefits or special tax treatments of the investors are applicable to the collective investment fund, on the basis of the transparency principle derived from the text of section 23-1, and therefore, are available to the investor.

For example, a Tax Authority ruling stated that the fixed assets special tax

allowance set forth in section 158-3 (tax benefit no longer in force under Colombian law), that gave a benefit for investment in such assets, could be taken when the fixed asset is acquired with resources of an investor and by a compartment of the collective investment fund, which belongs solely to said investor.

### Transfer of revenues and tax effects to investors

The revenues received by the collective investment fund are subject to either income tax or withholding tax, whichever is applicable to the fund investors.

In collective investment funds, investors are taxed only upon distribution of profits. It implies, therefore, that collective investment funds can be very efficient mechanisms to defer taxes that affect investors of the collective investment fund.

### Capital gains

The income obtained from the sale of shares registered in the Colombian Stock Exchange does not constitute taxable income or capital gain when their owner is the same real beneficiary and when the said sale does not exceed 10% of the subscribed shares of the company during the same taxable year. In this case, the withholding tax is not applicable.

In case the abovementioned requirements are not fulfilled, the income obtained from the sale of the shares shall be considered taxable income for the shareholder.

Taxable income from other capital gains, including the sale of shares not listed on a Colombian Stock Exchange, and the taxable income on the sale of assets located in the country will be the positive difference between the sales price and the fiscal cost of the assets sold.

Fiscal cost is defined as acquisition cost plus cumulative fiscal readjustments.

Sales price is defined as the price which is mutually agreed upon by the parties, which cannot differ more than 25% from the prices set for trading goods on the selling date (commercial value). Nevertheless, if the sale is executed between a Colombian resident and a foreign affiliate, transfer pricing regulation must be observed.

Finally, if the shares are held for a period of two years or more, any income coming from the sale operation could qualify as an occasional gain or loss, subject to special treatment in the annual income tax returns of the taxpayer.

If the seller is a foreign entity without fiscal domicile or residence in the country, the following rules must be observed:

- If the assets are sold to another foreigner not resident or not domiciled in Colombia for fiscal purposes, no withholding tax will apply.
- If the assets are sold to a Colombian resident or one domiciled, who must act as withholding agent, a 14% withholding tax will apply over the gross payment or accrual.
- In both previous cases, the foreign seller must file an income tax return within the month of the sale date and pay tax at 33% of profit and the 14% withholding tax can be taken as credit.

## Tax treatment for foreign portfolio investments in Colombia

For the determination of income tax on profits obtained from foreign capital portfolio investments, regardless of the modality or vehicle used by the investor to perform the investment, the following rules must be applied:

- Foreign capital portfolio investors are contributors of income tax for profits obtained from developing their activities.

- The income tax generated will be fully paid by means of the withholding tax levied at the end of each month by the administrator of this kind of investment, or the entity who acts as the administrator.

- Any other entity, different than the entities indicated in the previous point, which performs payments, directly or indirectly, to foreign capital portfolio investors will abstain from levying the withholding tax that would be applicable according to the Tax Code. When the income corresponds to taxed dividends, the withholding tax will be levied by the company paying the dividends, at the moment of payment or accrual; in this case the rate of the withholding tax will be of 25%, without considering that the withholding tax is overpaid

- The taxable basis of the withholding tax will be the profit obtained by the investor during the month under consideration; also the profit will be equal to the difference between the result, defined according to the following five rules, and net costs of administration in Colombia:

1. In cases of derivative financial instruments, the result will be determined according to the net value of payments or accruals executed, in favor of and against, directly or indirectly, to the investor, as a consequence of clearing and fulfillment of all derivative financial instruments, which have been expired or cleared in the respective taxable period.

In cases of swaps, the result obtained before expiration, which corresponds to clearing of each flow of the respective instrument, forms part of the taxable basis in the period in which they are paid or credited on account.

2. In cases of securities with yields or discounts, the result of positions in the portfolio and of sales of such securities, will be equal to yields, determined according to the procedure established for residents for calculating the withholding tax over financial yields originating in fixed income securities.

3. In cases of report operations, simultaneous operations and temporary transfer operations, the withholding tax will be levied exclusively at the moment of final clearing of the respective operation and the result will be determined based on the net value of payments or account deposits made directly or indirectly, in favor of and against the investor.

4. For other cases, not expressly regulated, the result will be equal to the net value of payments or accruals made directly or indirectly, in favor of and against the investor, as a consequence of the respective operation. The application of withholding tax is excluded for all income that does not constitute income or occasional gain, exempt income and taxed dividends, which are earned, directly or indirectly, by the foreign investor in its foreign capital portfolio investment.

5. The general withholding tax rate will be 14%, as long as the foreign capital portfolio investor is domiciled in a jurisdiction not classified by the national government as a tax haven. In a case where the investor has residence in a country qualified as tax haven, the general rate will be 25%.

- The withholding tax levied, according to the previous rules, will constitute the final income tax of the investors mentioned above. In this case, investors will not be obligated to submit an income tax return. If profits exceed the limit established in section two of article 36-1 (sale of stock listed in a Colombian Stock Exchange as revenues that do not constitute income or occasional gain), the investor will be obligated to submit an income tax return only for the profits referred to in that article, on the date established by the national government. For that purpose, the administrator will submit the respective income tax returns in the name and on behalf of the investor.

- The remuneration earned by the company or entity in charge of the administration of investments indicated above, constitutes taxable income for the respective administrator. In this case, the company or entity (the administrator) will apply the withholding tax established for commissions.

- Losses incurred by the investor in the month during which deductibility is not limited to residents, according to general provisions, may be set off against profits of the following months. The withholding tax, which results in an excess in a month, may be deducted from the withholding tax of the following months, within the following 12 months.

The losses incurred by the investor up to December 31 of one year may be amortized with the profits of the next taxable year. The losses that are not amortized during such a year will not be amortized in the following periods.

The provisions established in the above-mentioned rules will be fully applied to foreign capital investment funds, which had been authorized and had been in operation before the expedition of Decree 4800 of 2010.

The administrator, or the entity which acts as the administrator of foreign capital portfolio investments, is

responsible for providing information to the tax authority, which is used for studies and for information crossing proceedings, in the name of and on behalf of the investor.

## Tax treatment of reorganizational mergers

The legal requirements for a re-organizational merger to be non-taxable in Colombia are:

1. The tax basis of all assets in the merger must be the same before and after the merger; this has to be noted in the act of merger.
2. The tax treatment of all assets in the merger must be the same before and after the merger.
3. With respect to the shareholders, 85% of the shareholders of the entities being merged must participate in the entity resulting from the merger, with the same proportion of shares held before the merger.

4. The value of participation of the shareholders after the merger must be at least of 90% of the consideration received in the valuation mechanism and the exchange rate ("relación de intercambio") adopted during the merger.
5. If the shareholders sell their shares in the resulting entity from the merger in the following two years after the merger, there will be an income tax on that sale, which will be increased by 30%, (i.e., if the income tax is equal to \$10; it should be increased by three, which corresponds to 30%; in other words, the final income tax will be \$13). In this situation, the tax due cannot be lower than 10% of the value assigned to the shares in the merger.
6. For the shareholders, the tax treatment of the shares will be the same before and after the merger.
7. In the merger, the shareholders can only receive other shares from the resulting entity of the merger. If, for any reason, a shareholder receives cash or other assets in the merger, the transaction will be subject to income tax for the shareholder.

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