The Brief

June 2013 - No. 2

South-East Europe - Legal Update

Investment Incentives

In this issue:

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EDITORIAL

EU influence on investment framework and incentives in the SEE region

By welcoming yet another member-State from the SEE region, with Croatia's accession on July 1st, and by announcing the decision to open accession negotiations with Serbia by the start of 2014, the European Union has recently sent extremely positive signals in terms of investment in the SEE region. It seemed this was the perfect time to dedicate our second issue of the SEE Group Newsletter to the investment framework in the region, with a special focus on investment incentives.

When assessing where to invest, investors not only consider the country's general economic features such as openness, stability, labour cost and infrastructure reliability, they also give high importance to the level and type of available investment incentives. Both the general investment climate and the types of available incentives are greatly influenced by the country's actual or expected EU membership.

With regard to the general economic and legal factors that contribute to attracting investment, being an EU Member State boosts the development of reliable institutions and legal framework (as illustrated in detail in the article on Croatia featured in this issue), on top of granting the benefits of free access to the entire EU market. Investors can therefore count on an overall level of reliability, stability and ease in cross-border business activities when investing in EU member-States such as Croatia, the Czech Republic, Slovenia or Slovakia.

Even the prospect of EU membership strengthens these guarantees of stability and transparency, as well as perspectives of economic growth. Throughout the Stabilization and Association Process involving the countries of the Western Balkans[1], specific requirements of political and economic stability have been targeted and certain enlargement process instruments such as access to the EU market have been gradually implemented. Among others, Serbia, Montenegro, Bosnia and Herzegovina, Kosovo and Macedonia therefore benefit from a great proximity with the EU, not only geographically but also with respect to their investment framework.

With regard to investment incentives in particular, EU membership gives access to additional funds (EU structural funds) enabling the financing of such incentives, but implies at the same time that all member countries must apply strict EU regulations on State aid. Non-EU countries therefore benefit, to a certain extent, from more leeway in the creation and implementation of investment incentives. In Bosnia and Herzegovina for example, this considerable margin of manoeuvre is illustrated by the existence of a wide variety of incentives, corresponding to different programs set at each level of government. The EU regulations however impose a harmonized legal framework for granting investment incentives, that offers a higher level of transparency and is aimed at achieving sustainable economic growth and development. National regional aid must target specific areas as a way of redressing regional disparities[2]. As a result, no incentives can currently be granted by the Czech Republic and Slovakia for projects respectively in Prague and in Bratislava, because these cities already enjoy a positive economic status. Less developed regions however offer many advantages to investors, through a wide variety of forms investment incentives.

* * *

In the SEE region, both EU and non-EU countries benefit from the positive influence of actual or expected EU membership respectively. The overall investment framework is gradually reaching a higher level of stability and transparency, gaining investors' trust and creating lasting positive economic effects in the SEE region. Considering, in addition, the variety of existing measures to support investment - detailed in this issue of our Newsletter - and the substantial funds allocated to incentives, the SEE region constitutes a privileged terrain for investment opportunities.

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1 http://europa.eu/legislation_summaries/enlargement/western_balkans/r18003_en.htm

2 Guidelines on national regional aid for 2007-2013, Official Journal of the EU, C 54/13.

CROATIA

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Influence of EU accession on Croatian investment incentives

The accession of Croatia to the EU on 1 July 2013 has led the Croatian government to cooperate with the EU institutions in order to fulfil the demanding task of fully preparing Croatia to the upcoming EU membership. This included setting a legal framework for investment incentives, through the enactment of a series of laws and regulations which fully implement the relevant EU legislation regarding investments. In addition, several institutions aimed at supporting investors and promoting investments in Croatia through the implementation of investment incentives exist. The Croatian government has also implemented investment programs and strategies to further increase Croatia's attractiveness to foreign investors. This quickly improving investment climate should be further boosted by Croatia's EU accession, as it will benefit from an increased allocation and simplified management of EU funding in order to support investment.

Legal framework

The Act on Investment Promotion and Improving the Investment Climate (the "**Investment Act**") was adopted in compliance with the Guidelines of the European Commission on regional aids and prescribes different types of measures aimed at improving the investment climate. In compliance with the framework set at European level, the Investment Act introduced, among others, incentives to benefit micro-entrepreneurs as well as tax and customs incentives which are aimed at strengthening competitive capacities in production, development-innovation, business support and high value-added service activities. In addition, this act made a variety of costs eligible for calculating the total amount of available investment incentives, such as the costs of land acquisition, of new jobs and of licences related to the investment projects.

The Investment Act is complemented by a Regulation on Investment Promotion and Improving the Investment Climate which prescribes the compulsory form and content of applications for the investment incentives provided by the Investment Act, the related application and approval procedures as well as the mandatory content of the annual investors' report on the use of the incentive measures.

Apart from the legislation aimed at creating and regulating investment incentives, other acts and regulations also influence the Croatian investment climate, such as the Companies Act, the Capital Market Act, the new Encumbrance and Bankruptcy Acts - all of which are fully in line with the EU legislation.

Main institutions and agencies supporting investors

Croatia has created a number of institutions and agencies in order to ease investors' access to investment incentives. The Ministry of Entrepreneurship and Crafts is in charge of administrative tasks and promoting foreign investments and competitiveness in areas of small and medium size enterprises. HAMAG INVEST, an agency acting under the supervision of the Ministry of Entrepreneurship and Crafts, provides information about legislation, incentives and potential suppliers to small and medium entrepreneurships and assists them with applications for investment incentives, thus facilitating communication between investors and Croatian authorities. The Croatian Chamber of Economy has a special Investment Promotion Centre which provides support to investors in solving administrative and legal procedures during the project implementation, for example by editing a manual presenting the different forms of business available in Croatia, and assists investors in finding a suitable business partner. The government Agency for Investments and Competitiveness also has a proactive role in attracting investment projects and providing assistance and practical information to foreign and domestic investors.

Key investment incentives of the Investment Act

The Investment Act provides for the following investment incentives[3]:

- Tax Incentives - decrease of the 20% corporate income tax rate by 50%, 75% and 100%, depending on the amount of the investment[4] and the number of new jobs created.

TAX INCENTIVES				
Investment amount	Number of new jobs created	Corporate income tax rate	Number of years	Minimum period for maintaining the investment and newly created jobs**
≥ 50,000*	≥ 3	10%	5	3 years
0.15-1 Mio EUR	≥ 5	10%	10	5 years (LE) 3 years (SME)
1-3 Mio EUR	≥ 10	5%	10	5 years (LE) 3 years (SME)
≥ 3 Mio EUR	≥ 15	0%	10	5 years (LE) 3 years (SME)

* Only micro enterprises (total assets or yearly income max ca. EUR 2,000,000.00, max. 10 employees) can use incentive measures for investments starting from EUR 50,000;

** This period cannot be less than the period of use of the incentive measures.

- Non-Refundable Aid - different types granted as described in the tables below:
  - for eligible costs of new jobs created - depending on the unemployment rate in the county in which the investment is located;
  - for eligible training costs - depending on the size of the enterprise and the type of the training;
  - for capital investments above EUR 5 Mio and above 50 new jobs created - depending on the unemployment rate in the county in which investment project is located;
  - for new jobs created in labour-intensive investment projects - depending on the number of new jobs created.

NON-REFUNDABLE AID FOR ELIGIBLE COSTS OF NEW JOBS CREATED	
County unemployment rate	Aid amount (as a percentage of two year gross salary costs)
Up to 10%	10%, not exceeding EUR 3,000 per new job created
10-20%	20%, not exceeding EUR 6,000 per new job created
Above 20%	30%, not exceeding EUR 9,000 per new job created

NON-REFUNDABLE AID FOR ELIGIBLE TRAINING COSTS		
Enterprise category	Aid amount (as a percentage of the eligible training costs)	
	Specific training	General training
Large	25%	60%
Medium	35%	70%
Micro and small	45%	80%

NON-REFUNDABLE AID FOR CAPITAL INVESTMENT PROJECTS			
Investment amount	Number of new jobs created	County unemployment rate	Investment amount (as a percentage of the eligible costs of purchasing long-term assets)
≥ 5 Mio EUR	≥ 50	10-20 %	10%, not exceeding EUR 0.5 Mio
		≥ 20 %	20%, not exceeding EUR 1 Mio

NON-REFUNDABLE AID FOR NEW JOBS CREATED IN LABOUR INTENSIVE INVESTMENT PROJECTS		
Number of new jobs created		
≥ 100	≥ 300	≥ 500
Increase in non-refundable aid for new jobs created from Table 6 by:		
+ 25%	+ 50%	+ 100%

[3] For the purpose of the tables presented, LE: Large Enterprises; SME: Small and Medium Enterprises, whereby Small Enterprises are those with total assets of max ca. EUR 4,400,000, max. yearly income ca. EUR 8,700,000, max. 50 employees, and Medium Enterprises are those with total assets of max ca. EUR 17,400,000, max yearly income ca. EUR 34,700,000, max. 250 employees.

[4] Investment in fixed assets entered in the ownership of the incentive measures beneficiary (new businesses, expansion of existing businesses or fundamental change of business Art. 6 IA).

Key investment programmes and strategies

- Business Impulse 2013

This investment programme was implemented by the Croatian government to grant subsidies to SMEs. It has secured subsidies for the development of SMEs and crafts amounting to almost EUR 25 Mio in the year 2013, and is considering a much simpler procedure for granting the subsidies. In comparison with Business Impulse 2012, the number of required documents for subsidies is reduced from 30 to 8, saving entrepreneurs, in general, over EUR 600,000 per year.

- New national tourism strategy

The Croatian government took significant steps towards improving the investment climate in this economy area, including the new national tourism strategy for 2014-2020. The new national tourism strategy is considering new investments worth about EUR 7 billion, improvement of structure and quality of accommodation and the creation of ca. 31,000 new jobs (21,000 directly and 10,000 indirectly). This strategy was followed through the implementation of various measures - privatization of state enterprises, enhancement of business conditions to compete with similar destinations, better crediting conditions for tourism development projects, better use of EU Funds and proactive fiscal politics.

Increased allocation and simplified management of EU structural funds

With its accession to the EU, Croatia will have an opportunity to use considerable means from EU structural funds. For the second half of 2013, around EUR 450 Mio should be made available, and starting from 2014 around EUR 1 billion per year will be allocated to Croatia. A large portion of these funds will be made available to support small and medium businesses. Companies established in Croatia by foreign investors will be able to compete for EU funds with domestic ones under equal conditions.

In addition, with the accession of Croatia to the EU, the ex-ante control of public procurement to be financed from EU Funds will be abolished. This means that Croatia will carry out public procurement and contracting in accordance with EU rules through its own independent system of management and control, thus greatly simplifying the access to EU funds in the field of public procurement.

Conclusion - a number of good reasons to invest in Croatia

Corporate Tax Treatment	Only 20% of Corporate Income Tax with additional 12% of Dividend Tax, various investment related reductions
Use of EU Structural Funds	Second half of 2013 around EUR 450 Mio is planned, starting from 2014 around EUR 1 billion per year will be available
Attractive Investment Incentives	Corporate Income Tax Deduction, Non-Refundable Aids
Modern Transport Infrastructure	Modern highways, 6 sea ports and 7 international airports offer great possibilities for multimodal transport of goods
Excellent Geo-Strategic Position	Three major Pan-European corridors pass through Croatia making it the shortest route between Western Europe and Asia, Eastern Europe and the Mediterranean - perfectly positioned for reaching the EU market as well as the markets of Southeast Europe

CZECH REPUBLIC

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Overview of investment incentives available to foreign investors

Investment incentives in the Czech Republic are regulated by the Act No. 72/2000 Coll., on Investment Incentives, which is in line with the European law on state aid compatible with the common market. The subjects eligible to apply for the aid are Czech and foreign companies, as well as individual entrepreneurs. Only investments located in the Czech Republic can be supported. Incentives are available only to future investments. It is, therefore, imperative that before the project commences, the confirmation on registration of the application for the incentive is issued by the investment and business development agency of the Czech Ministry of Industry and Trade (named *CzechInvest*). The incentive cannot be provided if the investor's own funds concerning the investment are spent before the investor files the application and unless the agency confirms the application is satisfactory.

General conditions for the award of incentives

The aim of investment incentives is to motivate investors to invest in selected areas of business. These are the manufacturing industry, technology centres and business support service centres. The conditions that an investor must fulfil in order to be granted with the incentive vary depending precisely on the area of business chosen from among the three on offer:

➢ Incentives in manufacturing industry

The sectors in the manufacturing industry supported by the incentives are defined by reference to the classification of economic activities of the Czech Statistical Office. These sectors are, for example: the automotive industry, the air and space industry and mechanical engineering.

To qualify for the incentive, the investment needs to fulfil the following conditions:

- Reach the minimum threshold amounts ranging from EUR 2 million to EUR 4 million, depending on the region of the Czech Republic,
- At least half of the investment has to be financed from the investor's own resources, and
- The investment has to be used for acquiring long-term tangible and intangible assets.

Investments in the manufacturing industry exceeding EUR 20 million, of which at least EUR 10 million is invested in new machinery, and creating at least 500 new jobs, are considered to be strategic investments. Strategic investments are eligible for an additional form of incentive, namely the cash grants described below among the different forms of incentives.

➢ Technology centres

Technology centres are businesses focused on applied research, development and innovation in order to develop technically advanced products, technologies and production processes for use in production and increasing the added value of products.

To qualify for the incentive, the investment needs to fulfil the following conditions:

- To reach the minimum threshold amount of EUR 400,000;
- At least half of the investment must be financed from the investor's own resources;
- The investment must be used for acquisition of long-term tangible and intangible assets, and
- The investment must create at least 40 new jobs.

Technology centre investment can be also considered strategic investment eligible for cash grants. In order for an investment in a technology centre to receive the status of the strategic investment, its amount must exceed EUR 8 million, of which at least EUR 4 million must be invested in new machinery. It must concurrently create at least 130 new jobs.

➢ Business support service centres

In this field, incentives should support high-tech repair centres software-development centres and shared service centres focused on taking over the management, operation and administration of internal activities such as accounting, finance, HR administration, marketing and administration of information systems.

To qualify for the support, the investment in software-development centres must create at least 40 new jobs and at least 100 new jobs in case of investment in other business support service centres.

Form of incentives

Investment incentives can be awarded in the form of corporate income tax relief; transfer of land for favourable prices; job creation grants, training and retraining grants; and cash grants on capital investment.

➢ Corporate income tax relief

The tax relief is the most common form of incentive awarded. The amount of the relief depends on the amount of the investment and the ceiling of state-aid, as stipulated by the Regional Map of State Aid Intensity for the Czech Republic. The map divides the territory of the Czech Republic into regions and sets out for these regions the maximum allowed state aid in percentage points of the total invested amount. In the majority of regions the ceiling is set at 40% of the total investment, while in some regions of south west Bohemia the ceiling is lower, set at 30%. The capital city of Prague is not eligible for this type of support at all.

Investors may deduct the amount of the tax relief from the due amount of corporate income tax[5]. If the whole tax relief is not utilized immediately after making the investment, it can be carried forward and utilized during the next ten years.

➢ Transfer of land for favourable prices

The transfer of land for favourable prices refers to a sale of land owned by the state, its organizational units or by municipalities at a price below the market price. The difference between the transfer price and the market price is considered to be the incentive.

➢ Job creation grants and training and retraining grants

Cash grants supporting the creation of jobs are available only in regions where the unemployment rate stands at least 50% higher than the average unemployment rate in the Czech Republic. The amount of the grant is EUR 2,000 per newly created job. Cash grants for training and retraining amount to 25% of the total training and retraining costs. As with other forms of incentives, general conditions for the award of incentives must be fulfilled to take advantage of these grants.

➢ Cash grants on capital investment

This form of aid is provided only to strategic investments. Provision of the aid requires approval from the Czech government. Cash grants can be provided in the amount of up to 5% of eligible investment costs. The incentive cannot, however, exceed EUR 60 million for a manufacturing project or EUR 20 million for a technology-centre project. If commencement or expansion of production and establishment or expansion of a technology centre occurs simultaneously within the given investment, then the amount of cash grant can be up to 7% of the eligible investment costs. Nevertheless, this support cannot exceed the amount of the state aid ceiling, as stipulated in the Regional Map of State Aid Intensity for the Czech Republic.

Investments supported by incentives

The relevant authorities indicate that, in the last fifteen years, investment incentives were provided to 709 investors. The vast majority of them were foreign investors, with German, Japanese and Dutch investors being the most active. These investments were made mainly in the automotive, engineering, electronics and chemical industries. The investments covered all regions of the Czech Republic apart from the capital city of Prague, as its positive economic environment does not justify support by incentives. Regions, Usti nad Labem, Moravia-Silesia and Central Bohemia receive the most aid.

The total amount invested in the Czech Republic over the last 15 years supported by investment incentives exceeded EUR 20 billion, showing the positive effect of the Czech investment incentives on its economy, attracting investors and enabling major projects to be carried out - the largest individual supported investment was made by Hyundai Motor Company in the automotive industry and exceeded EUR 1.18 billion.

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[5] The current corporate income tax rate in the Czech Republic is 19%.

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Overview of investment incentives available to foreign investors

A company's decision on the location of its next investment may be significantly influenced by the amount and structure of incentives that could be provided by the State for such an investment.

Due to considerable regional differences in the Slovak Republic, the primary role of incentives is to motivate the investors to direct their investments towards the regions with higher unemployment rates. This goal is reflected in the requirements for the provision of investment incentives, as stated by the Act on Investment Incentives. It must however be noted that even if the investment project meets the statutory requirements, there is no legal right to obtaining the investment aid. The decision to provide the incentive is made solely to the discretion of the relevant state authorities.

General requirements for the provision of investment incentives

Four categories of projects can benefit from investment incentives: industrial production, technological centres, shared service centers, and tourism projects.

The general conditions for the provision of investment incentives for such projects are as follows:

Type of project		Minimum amount of the investment* (in EUR)	Share of new technology** in the total amount of investment	Minimum amount of equity	Other requirements
Industrial production	Employment rate in the district is below State average	10,000,000	60%	50%	• The production activities shall meet the environment protection requirements, • The entire investment shall be completed in one single location, i.e. the area of land on which the facilities for production, development or research shall be built.
	Employment rate in the district is above State average	5,000,000	50%	50%	
	Employment rate in the district is at least 50% above State average	3,000,000	40%	50%	
Technological centres		500,000	-	50%	• Investor shall employ at least 70% of university graduates.
Shared service centres		400,000	-	50%	• Investor shall employ at least 60% of university graduates.
Tourism	Employment rate in the district is below State average	10,000,000	40%	50%	• The project activities shall meet the environment protection requirements; • The entire investment shall be completed in the same district.
	Employment rate in the district is above State average	5,000,000	20%	50%	
	Employment rate in the district is 50% above State average	3,000,000	20%	50%	
In order for existing establishments to qualify for the incentive, their expansion has to consist in an increase in the number of employees by at least 10% (however always by at least 40 new jobs) and an increase in the production volume or turnover by at least 15%.					

* For the purposes of granting the incentive, the costs of acquisition of land, buildings, technological equipment and machinery acquisition as well as intangible fixed assets (such as licenses and know-how costs) are considered as eligible costs.

** The technologies must be new, acquired under market conditions and manufactured up to three years prior to commencement of their operation.

It should be noted that regional aid is limited by EU legislation, which states the maximum limits of investment incentives (maximum investment intensity calculated as percentage of the eligible investment costs). These limits are reflected in the division of the Slovak Republic into five zones, based on the criterion of recorded unemployment rate. Therefore, it is not possible to provide investment incentives in the districts in Bratislava, the capital of Slovakia, where the unemployment rate is rather low, in comparison with other regions of the country.

Form of investment incentives

The investment incentives may be provided in the form of:

- Subsidies for acquiring of long-term tangible and intangible fixed assets. It can be provided only if the investment is located in a region whose unemployment rate is higher than the average unemployment rate recorded in Slovakia the previous year.
- Contribution to the creation of a new working position - the amount of such contribution depends on the particular region of the investment. It can be provided only if the investment is located in a region whose unemployment rate is higher than the average unemployment rate recorded in Slovakia the previous year.
- Disposal, by the State, of real estate at a price lower than the general value of the property in question - in case there is a difference between the market price of the real estate and the price at which the transfer is realized.
- Income tax relief **-** this form of investment incentive may be applied during five subsequent taxation periods. The investor benefits from a tax relief proportionate to the amount of eligible costs of the investment for which the incentive was approved.

Obligations of the investor

During the completion of the investment project, at least 25% of the value of the eligible costs has to be financed from own sources or by means of external funding.

Once the investment incentive is granted, the investment project must be realized within three years following the approval of the investment aid. Large projects (projects with eligible costs exceeding EUR 50,000,000) have to be completed within five years.

In order to ensure that the investment incentive will meet the expectations, the investor must ensure that the number of new jobs created and their occupation shall be preserved for at least five years. A job created in direct connection with the investment project must be occupied within three years following realization of the investment project.

Investments supported by incentives

Since 2002, the Slovak Republic provided around 128 investment incentives to 113 investors. The total amount of the incentives provided by the State reached almost EUR 1.4 billion. A majority was provided to investors in the automotive, engineering and electronics industries such as PSA Peugeot Citroen (Trnava), Kia Motors (Žilina), Volkswagen (Bratislava), Foxcon (Nitra) or Samsung Electronics LCD Slovakia (Galanta). The incentives were provided throughout all regions of the Slovak Republic, but were most concentrated in the districts of Košice and Žilina.

BOSNIA AND HERZEGOVINA

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Overview of investment incentives available to foreign investors

Similar to other countries in the region, Bosnia and Herzegovina ("**BIH**") is creating a favourable FDI environment in order to enhance economic growth and pull the country out of the recession.

As a result, BIH introduced a variety of investment incentives, which provide a wide palette of options for potential investors. Given the country's territorial and administrative organization, investors have the opportunity to select and combine different incentives available at: (i) State level, (ii) level of the entities (Republic of Srpska and Federation of BIH)[6], (iii) cantonal/municipal level (including Brčko District)[7].

[6] Bosnia and Herzegovina is characterized by two different legal jurisdictions within the State. Namely, BIH is divided into two so called "entities", being Republic of Srpska and Federation of BIH. Each of the entities has its own legislative branch and passes laws applicable on its territory. On the other hand, some matters are regulated solely on the State level, therefore having the same rules applicable for both entities.

Given that foreign investors are guaranteed national treatment and therefore have the same status as domestic companies, they can apply for all types of incentives without restriction.

Incentives awarded at State level

At State level, the Foreign Investors' Support Fund, created in 2007, is an important source of investment incentives. Its aim is to allocate grants to eligible foreign investment projects, with the help of the Foreign Investment Promotion Agency (the "**FIPA**"). Although the activities of the Fund have decreased over recent years due to limited budget, the FIPA expects a positive trend in raising the funds available for FDI grants in the near future. In addition to these funds, certain customs exemptions exist at State level, and apply equipment imports as part of the share capital of the investor. This customs exemption is however not applicable to passenger vehicles, slot and gambling machines.

Incentives awarded at entity level

At entity level, both the Federation of BIH and the Republic of Srpska have developed their own incentive policy.

The Federation of BIH provides for example an attractive corporate income tax holiday as follows:

- When a taxpayer achieves 30% of its total revenue through export, it will be exempted from paying tax for that year;
- A taxpayer investing a total value of minimum 20 million BAM[8] in production over five consecutive years is exempted from paying taxes for five years as of the first investment year, provided that at least 4 million BAM are invested the first year;
- A taxpayer who employs over 50% of disabled persons and persons with special needs for over one year is exempted from paying taxes for the year during which such workers were employed.

The Republic of Srpska introduced two main types of incentives, namely corporate profit tax base reductions and financial incentives for direct investments:

- Corporate profit tax base reductions are granted: (i) by excluding investments in production equipment or in immovable property used for manufacturing and processing activities from the overall value of the taxable investment, as well as (ii) by excluding from the taxable base the value of paid personal income tax and contributions, provided that 30 new workers were employed during the given calendar year.
- Financial incentives for direct investments are conceptualised in a similar way as those in Serbia, but target only the manufacturing sector. Mainly, the Republic of Srpska is awarding funds to projects that boost employment, transfer knowledge and technology, and contribute to regional balance. The total amount of funding ranges from BAM 3,500 to BAM 5,000 per new job created, depending on the level of development of the targeted municipality. Also, for certain large size projects, up to 15% of the overall investment value can be financed by such funding.

In addition to these specific incentive programs, sectoral incentives are also available in both entities, such as incentives for tourism, agricultural subsidies, and others allocated from the state budgets.

Incentives awarded at lower levels of government

Finally, a large number of lower levels of government, such as cantons and municipalities, develop incentive programs within the scope of their jurisdiction. These incentives consist e.g. in exempting investors from utility fees or from different local levies, providing building land for the realization of their projects or facilitating administrative procedures.

Investments supported by incentives

According to the FIPA, many foreign investors in BIH benefited from different combinations of the above presented incentives. For example, a variety of tax and customs incentives helped Bekto Precisa, leader in the production of highly sophisticated tools for plastic and metal injection, developed its activities from its location in the industrial cluster in Gorazde. Also, some investors are expected to apply for the incentives in the near future, such as the announced Henkel Ceresit Greenfield project.

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[7] Another territorial specificity of BIH is the existence of Brcko District, a self-governing administrative unit, representing a formally part of both BIH entities, with surface of 493 km^2.

[8] BAM is directly linked to the Euro, under fixed exchange rate (1 BAM: 0,51129 EUR).

SERBIA

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Decree encouraging financial incentives for direct investments

In these challenging times for emerging markets, Serbia has put significant efforts into attracting direct investments. After a GDP drop of 1.7% in 2012, direct investments are seen as key to the country's economic recovery and growth.

Some of the general FDI friendly parameters include low tax rates and a variety of tax incentives, cost effective and skilled labour force, as well as numerous free trade agreements, allowing custom free access to 15% of the world market. It is also worth noting that this year's Doing Business Report ranked Serbia among the 10 economies in the world having most facilitated the conducting of business across several areas of regulation.

In order to further encourage investing in Serbia, the Government passed a Decree in 2012 that provides legal basis for allocating non-refundable financial incentives for direct investments (Decree on conditions and manner of attracting direct investments, the "**Decree**"). The Decree is one in a series of similar legal acts aimed at boosting direct investments in the country.

The purpose of the Decree is to attract both foreign and domestic direct investments, with a special focus on job creation, transfer of knowledge and technologies, balanced regional development and investment in tourism.

The Decree offers a possibility to apply for non-refundable state funds, granted for new investments in fixed assets, within: (i) the manufacturing sector (both greenfield and brownfield investments), (ii) the sector of internationally marketable services, or (iii) the tourism sector. Projects in the primary agriculture, hospitality, trade/retail sector and projects involving production of synthetic fibres or coal are not eligible to receive funding.

Generally, the Decree lays down specific criteria for awarding of funds, such as investor references, participation of domestic suppliers, sustainability/longevity of the investment, introduction of new technologies etc.

The total amount of financial incentives allocated to the project is determined according to two different regimes, depending on the size and type of the investment project:

- For standard-sized projects, a scoring system is applied, where a certain number of points are awarded for each eligibility criteria, and the amount allocated to a project is determined depending on the overall number of points realized by the specific project, ranging from EUR 4,000 to EUR 10,000 per each new job created.
- For large and medium-sized projects[9], the same eligibility criteria as the ones used for standard-sized projects are applied, but are not subject to scoring. The amount of incentive funds which may be awarded to large and medium-sized investment projects is determined as a percentage of the overall investment value. Large projects of a value exceeding EUR 100 million and medium-sized projects receive funds covering up to 17% of the total investment value, while large projects of a value between EUR 50 and 100 million receive funds covering up to 20% of the total investment value.
- For large-scale investments designated as investments of special importance[10], the use of PPP vehicles is allowed for particular investments, while the terms of funding are negotiated directly with the highest level of government.

The procedure for awarding financial incentives is initiated with a public call to all interested investors, which is prepared and published by the Serbia Investment and Export Promotion Agency (the "**SIEPA**"), a public body that has already proven to be a reliable partner to investors in the country. A special Commission then considers the

[9] A *large investment project* is an investment that contributes to the development of the economy of the Republic of Serbia, whose total value exceeds EUR 50 million and which creates at least 300 new jobs within the agreed timeframe (maximum ten years from the day the agreement regarding the awarding of funds is signed);
A *medium-sized investment project* is an investment that contributes to the development of the economy of the Republic of Serbia, whose total value exceeds EUR 30 million and which creates at least 150 new jobs within the agreed timeframe (maximum ten years from the day the agreement regarding the awarding of funds is signed);

[10] *Special Importance Investment* is an investment that contributes to the resolution of unemployment, increases exports or substitutes imports, and promotes the development of the economy of the Republic of Serbia, with total value exceeding EUR 200 million and that creates at least 1,000 new jobs within the agreed timeframe (maximum ten years from the day the agreement regarding the awarding of funds is signed);

applications received and submits a proposal to the Ministry of Economy, indicating the amount of funds to be awarded to the specific project. The final decision is approved by the Ministry, which also subsequently signs the agreement on the award of financial incentives with the beneficiary investor.

Judging by the figures, the Decree already started to show excellent results following a great deal of interest for this type of investment incentives. So far, SIEPA published 18 public calls in which approx. EUR 277 million were allocated for funding of 254 direct investment projects in Serbia.

Some of the reputable foreign companies whose investments benefited from this type of state incentives include Bosch, Benetton, PharmaSwiss, Swarovski, Panasonic Lighting Devices and many others.

Given that application of the Decree expires on 31 December 2013, it is expected that at least two more public calls for the award of non-refundable state funds will be published in the forthcoming period. Therefore, interested investors should "be on the lookout" in case they would like their projects to benefit from the presented incentive programme.

SLOVENIA

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Second wave of privatization: sale of shares in key companies

With the first wave of privatizations between 1991 and 2004, Slovenia completed the transition for a socialist economy to a capitalist model. However, the State still maintains a controlling share in a number of companies and banks. This was considered a way to ensure protection of the national interests, but this approach no longer prevails. Most experts now believe that State involvement in these companies has led to high political interference in their management. A second wave of privatization is therefore starting, offering interesting investment opportunities through the acquisition of shares in these key companies.

The primary reason for this shift is based on the observation that State-owned companies are commonly not among the most successful in their respective sectors, and their business results were not optimal. This has become especially obvious in the recent years, during the financial and economic crisis, when many of the State-owned companies were faced with losses and financing difficulties. Most economic experts, supported by the current government, now believe that a second wave of privatization is required in order to provide a sustainable business model for those companies that had the State as majority stakeholder.

An additional reason in support of a new wave of privatization is the current economic crisis and the need to consolidate public finances with the inflow of fresh foreign capital. As a result, the Republic of Slovenia is actively seeking for a way to withdraw from certain segments of the economy.

As a first step, the Slovenia Sovereign Holding Act entered into force in December 2012, and was recently amended in April 2013. On the one hand, it has introduced measures that aim to ensure more efficient state ownership management in the companies where the controlling share of the state is to be maintained. The Act simplifies their management structure and defines the purposes and criteria for the management of government investment. On the other hand, public companies that are not considered of strategic interest are to be sold to interested investors. The Government will in most cases require an approval by the National Assembly, namely in cases where the companies founded by the Republic of Slovenia or its funds either own over EUR 20 million (accounting value) of the public company or own an equity share of at least 25% (individually, jointly or in combination).

The Government of the Republic of Slovenia has approved the draft text of the decision to sell investments of the Republic of Slovenia and adopted the 2013-2014 National Reform and Stability Programs. A new wave of privatizations has thus already started.

In the long term, the State expects that the wave of privatization will contribute to achieving sustainable macroeconomic goals and to ensuring stable growth of the economy through improving the quality and capacity of public services (by maintaining and developing the former public companies), the increase of efficiency and competition in the economic system, the opening up of new markets and the creation of jobs. From the State's financial perspective in the short term, the main purpose of a privatization is to obtain the highest possible purchase price when selling equity investments in order to provide budget revenue.

For investors, this new wave of privatization is the opportunity to acquire shares in key companies in Slovenia and thus benefit from a strategic establishment giving privileged access to markets in Central and South-East Europe. Public companies targeted by the privatization process are being identified by the Government, which has issued a draft decision authorizing the Slovenian Restitution Fund (SOD), in its quality as current manager of assets owned by the Republic of Slovenia, to sell its investment in 15 companies. For some of these companies, the procedure to dispose of public assets has already begun, while for others the procedure is not yet underway. Sales of State-owned shares shall be conducted by way of a public offer, public auction, public tender or offering of securities to the public.

The privatization process has already begun for the 5 companies listed below:

- **Adria Airways, d.d.,** is the leading Slovenian airline operator for non-scheduled and scheduled flights. Its network links Ljubljana with European cities and also offers excellent connections to South East Europe. In 2012, the public call was published for the sale of 74.87% of shares in the company.
- **Aero, d.d.,** a company operating in adhesives and coating compositions. In 2011, the company initiated the process of selling 55% of its shares.
- **Elan, d.o.o.,** a manufacturer of skis, sports equipment and boats. Faced with the need for continuing investment in the development of new products, the entry of a new investor in the company is necessary.
- **Fotona, d.d.** ranks among the global companies with the longest tradition in the field of laser optoelectronics. It is engaged in the manufacture and sale of products and services of high technology in the field of medical and industrial lasers. The procedure for selling the 70.48% of its equity holding was initiated in 2011.
- **Helios**, **d.d.** covers the key segments in the coating industry (decorative, industrial and car industry). The sale of 72.89% of the company’s shares began in 2012.

The privatization process has not yet commenced in the following companies:

- **Aerodrom, d.d.**: the company is the airport services operator at Ljubljana airport. In the event the National Assembly approves the sale, the company could be sold along with Adria Airways d.d. A joint sale is anticipated to increase the interest of potential investors.
- **Adria Airways Tehnika, d.d.** maintains and services aircraft for Adria Airways d.d.
- **NKBM, d.d.** is the second largest bank in Slovenia, with a significant market share and a significant commercial and retail network.
- **Telekom, d.d.** is Slovenia’s leading telecommunications provider. Its portfolio includes infrastructure services, fixed and mobile telephony, Internet, and advanced IT and multimedia services.
- **Cinkarna Celje, d.d.**: the company operates in the chemical manufacturing sector, and produces titanium dioxide and sulphuric acid. It also processes zinc and manufactures products for agriculture, construction etc.
- **Gospodarsko razstavišče, d.o.o.**, a leading events and exhibitions organizer in Slovenia.
- **Paloma, d.d**. is mainly known for the manufacturing of paper products.
- **Terme Olimija Bazeni, d.d.** is a company operating hotel and spa services.
- **Unior d.d.** operates the metal processing industry, and is also active in the tourism industry as the owner of several hotels and resorts.
- **Žito d.d.,** one of the largest food companies in Republic of Slovenia.

Although the approval of the National Assembly is still pending requiring that the State sell its equity holding in the above-mentioned companies, it is clear that the new privatization process had already begun. While the government is counting on the process to bring additional funding to the State budget, potential investors are monitoring the developments closely, on the lookout for attractive purchase opportunities.

MONTENEGRO

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Tax incentives

Aware of its limited market size and dependency on various factors, Montenegro focuses constantly on implementing liberal economic reforms. Such endeavours resulted in a significant inflow of FDI and rather stable economic growth.

The two main pillars on which Montenegro is building its economy are stability (political, monetary etc.) and openness. An open economy and business-friendly environment have become strong signals recognized by the investors, although further development through structural and regulatory reforms remains necessary**.** The step forward taken in the EU integration process, marking the start of accession negotiations in June 2012, represents a significant stability indicator.

Continuous liberalization and improvement of the business environment are intended to be the most significant incentives for attracting investors. The same idea is transposed in the tax system, which is currently one of the most competitive in Europe. The Montenegrin tax regime is characterized by comparably low level of tax rates, with a relatively broad tax base and few tax exemptions.

Both corporate income tax and personal income tax are levied at a flat rate of **9%.** The tax rate applicable to personal income was gradually decreased from 15% to 12%, and ultimately set at 9% from 2010 onwards. Therefore, personal income tax was on a par with corporate income tax, both being lower than in any other country in the region. However, it is to be noted that due to global economic crisis impact, Montenegro recently introduced a temporary "crisis tax" applicable until the end of 2013, for salaries and other labour-adjusted income amounts exceeding gross EUR 720 (approx. the average gross income in Montenegro). The crisis tax levied upon the excess amount is set at the increased rate of 15%.

Montenegrin law imposes a withholding tax on income realised from a Montenegrin source and distributed to a non-resident. It applies to profit distribution, capital gains, interest, royalties, rent, intellectual property fees, as well as fees for consulting, market research, and audit services. The general withholding tax rate is levied at a low level of **9%**. In some cases, entities may benefit from an even lower rate or an exemption provided by certain bilateral treaties.

Taxable supplies in Montenegro are subject to a general **19%** VAT rate and a reduced **7%** VAT rate, applicable to basic consumption goods (bread, milk, sugar etc.), certain medical supplies, computer equipment, tourist accommodation, maintenance services provided at marinas, etc. In addition, certain categories of goods and services are subject to **0%** VAT rate, including export of goods, goods and services related to international air and maritime transport or used to explore oil wells on high seas. Montenegrin law also provides a list of VAT exemptions. Some services placed on the list of exemptions include insurance/reinsurance, banking and financial services and gambling and entertainment. The Montenegrin Government recently increased the standard VAT rate from 17% to 19%, as a temporary measure to overcome difficulties in public finances. Nevertheless, Montenegrin VAT still remains very competitive in the region.

Given that main investor stimuli are concentrated on low tax burdens, there are only three types of tax relief that are directly related to business:

- Tax holiday for newly established businesses in non-developed municipalities: newly established production companies (or units of companies) located in underdeveloped municipalities are entitled to an 8 year tax exemption. A taxpayer operating in the sector of primary agricultural, transport, shipbuilding, fishery, and steel production cannot benefit from this tax incentive.
- Tax holiday for non-governmental organisations (NGOs): NGOs registered for profitable activity are permitted to decrease the corporate tax base by EUR 4,000, provided that profit is used for accomplishing goals of that NGO.
- Foreign tax credit: Resident taxpayers are entitled to a tax credit on foreign income up to the amount of corporate tax paid in another country on income realised in that country. This tax credit is equal to the tax paid abroad but may not exceed the amount that would be levied in Montenegro.

As presented above, the Montenegrin tax system remains highly competitive in the region, despite some unpopular measures taken in order to mitigate the effects of the global economic crises. In particular, Montenegro's low income tax rate is at a level which is characteristic for "Tax havens". This is a major factor of attractiveness for foreign investors.

Many foreign investors are present in Montenegro. Several important investment projects have recently been completed, such as the reconstruction of St. Stefan Islet in the Adriatic Sea, now managed by Aman Resort. Another illustrative example is the impressive Porto Montenegro project, the first marina for mega yachts in the Mediterranean. According to the Executive Director of Porto Montenegro, Oliver Corlette, "low tax rates and the willingness of the Government to transform Montenegro into a luxury tourism destination...were crucial reasons for the implementation of this luxurious project, the total value of which is estimated at EUR 600 million".[11]

MACEDONIA

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Incentives offered in Free Economic Zones

Due to strong trade ties, Macedonian economy is vulnerable to economic developments in Europe and is also dependent on regional integration and progress toward EU membership. Following its declaration of independence, Macedonia faced several serious challenges, but has managed to maintain macroeconomic stability with low inflation. The country has, however, lagged behind in the region with respect to attracting foreign investment and creating jobs. The official unemployment rate indeed remains high, at over 31% (but an extensive grey market estimated to be between 20% and 45% of GDP, is not depicted in the official statistics).

One of the main goals of Macedonian governments in the past decade was and still is to attract foreign direct investments. The efforts in this direction include, amongst other issues, implementation of extensive fiscal and business sector reforms. Also, the low taxes and relatively low-cost (but well-trained) labour force is a trump card that is often used by Macedonia to attract foreign investments.

In the wake of the global economic downturn, Macedonia has experienced less foreign direct investment and a large trade deficit. However, as a result of conservative fiscal policies and a sound financial system, in 2010 the country credit rating improved slightly to BB+ and was kept at that level in 2011-12. Macroeconomic stability has been maintained by a prudent monetary policy, which keeps the domestic currency pegged against the euro. As a result, GDP growth was modest, but remained positive at about 3% in both 2010 and 2011, and inflation was kept under control. The government loosened fiscal policy in 2012 and the budget deficit expanded to 3.5% of GDP.

In 2000, the Government of the Republic of Macedonia established the Directorate for technological industrial development zones (the "**Directorate**"). The Directorate is similar to the notion of free economic zones, but tends to offer far more advantages to investors. The Directorate manages four technological industrial development zones: TIRZ 1, TIRZ 2, TIRZ Stip and TIRZ Tetovo (the "**Free Economic Zones**" or "**Zones**"). In order to achieve more equal economic development in the country, seven more zones are planned for development.

Types of incentives offered to companies working in the Free Economic Zones:

- Tax incentives - Investors in Zones are entitled to a 10-year profit tax holiday and a 5-year 50% reduction in personal income tax, so that the effective rate of personal income tax amounts to 5%. Investors are exempt from payment of value added tax and customs duties for goods, raw materials, equipment and machines;
- Investment location - The land in Macedonia's Zones is available under long-term lease for a period of up to 99 years at concessionary prices;
- Exemption from fees - Investors are exempt from paying utility taxes, which enables free infrastructure connection to natural gas, water, sewage and electricity. Investors are also exempt from paying fees for land building permits;

[11] Source: Montenegrin Investment Promotion Agency.

- Faster business set up - Fast and efficient procedures for business activity registration are provided by the Directorate to all potential Zone users, thus further reducing the costs of setting up businesses;
- State grants - Macedonian Government participates in construction project costs incurred by the Zone user by up to EUR 500.000, depending on the number of the new employees and investment brought by the company.

Advantages of working in the Free Economic Zones:

Customs		
Goods	**Rates outside of the zones**	**Rates in the zones**
Raw material	0% - 15%	0%
Equipment and machinery	5% - 20%	0%
Taxes		
Goods	**Rates outside of the zones**	**Rates in the zones**
Value Added Tax	18%	0%
Profit Tax	10%	0% for ten years
Personal Income Tax	10%	0% for ten years

Companies working in the Free Economic Zones include: Johnson Controls, Van Hool Macedonia, Johnson Matthey, TeknoHose, Kemet, Protek Group and Motherson Group.

The increased effort State officials are making to offer attractive taxation packages and other additional incentives are also reflected in the incentives for Zone users. Alongside Macedonia's objective of joining the European Union, this creates an attractive environment for foreign investments in Macedonia. ■

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