

---

21 January 2019

**Taxation of a Shareholder's Income In the Acquisition of a  
Limited Liability Company's Own Business Share**

**1. Introduction**

This article aims to provide answers to a “hot topic” legal issue, often raised by shareholders, regarding the legal grounds for taxation of a natural person's income derived from selling his business share to his limited liability company (where the company acquires its own business share) in the Republic of Slovenia.

The Previous Personal Income Tax Act<sup>1</sup> stated that such income should be taxed as *dividend-like income*, while the valid law purposely abolished this provision. Since the adoption of the current legislation, the Supreme Court of the Republic of Slovenia has not ruled in such cases yet, therefore, there is still no Supreme Court case law guidance regarding such transactions. In addition, the Slovenian Tax Authority (Financial Administration of the Republic of Slovenia [*Finančna uprava Republike Slovenije*] – “**STA**”). perceives such commercial operations as risky transactions and diligently investigates whether they were carried out in accordance with the law.

---

<sup>1</sup> Personal Income Tax Act (Official Gazette of the Republic of Slovenia, No. 59/06 – official consolidated text and 117/06 – ZDoh-2).

Thus, the question remains as to whether the income generated from such transactions should be taxed as a dividend or should it be taxed as a capital gain? Moreover, what is the practical difference between those legal grounds for the shareholder?

## 2. Legal Grounds

There are two possibilities for the taxation of such transactions. Firstly, they may be taxed as a **dividend payment** or they may be taxed as a **capital gain**. Both are taxed at a flat rate of 25%, however, the difference between them is of a practical nature, since capital gain taxation is subject to a reduction of the tax rate by time (every five years of capital ownership)<sup>2</sup>, whereas the tax rate for dividend payment is set at 25% at all times.

In the past, the tax authority initially taxed such transactions based on several different legal qualifications (such as profit disbursement or benefits from an employment relationship), which was rejected by the court judgements, since this interpretation was not in accordance with the legislation of the time. Therefore, the so-called **dividend-like income** was introduced as a solution within the law, establishing an undisputable legal basis for taxation of such transactions.<sup>3</sup> *Dividend-like income* was taxed in the same manner as dividends as long as the company possessed undistributed profit<sup>4</sup> in the moment of the share capital reduction. Such an understanding of the law was also supported by the Supreme Court case law.<sup>5</sup>

The currently valid Personal Income Tax Act<sup>6</sup> abolished the institute of *dividend-like income* and did not substitute it with another similar provision. The act proposal of the current Personal Income Tax Act specifically states that the *dividend-like income* (apart from profit, distributed in accordance with debt securities, which guarantee the right to profit sharing) shall no longer be taxed as dividends.

In contrast to the previous law, and according to the current legislation, the subject of taxation in such acquisitions is the **realized capital gain**, i.e. the difference between the value acquired by the shareholder upon selling the business share (capital) and the price he paid upon

<sup>2</sup> Tax rate after five years shall be 15%, after 10 years 10%, after 15 years 5%.

<sup>3</sup> Kocbek, Marijan: Umik lastnega poslovnega deleža v d.o.o. – korporacijski, bilančni in davčni vidiki, Podjetje in delo št. 2, 2011, page 217.

<sup>4</sup> Article 79 of the previous Personal Income Tax Act.

<sup>5</sup> See Judgement of the Supreme Court No. X Ips 399/2008 of 19 August 2010.

<sup>6</sup> Personal Income Tax Act (Official Gazette of the Republic of Slovenia, No. 13/11 – official consolidated text, 9/12 – Supreme Court Judgement US, 24/12, 30/12, 40/12 – ZUJF, 75/12, 94/12, 52/13 – Supreme Court Judgement, 96/13, 29/14 – Supreme Court Judgement, 50/14, 23/15, 55/15, 63/16 in 69/17).

acquisition of the share. Although the transaction occurs between a shareholder and his company, and not, for example, between two shareholders or a shareholder and a third party, the parties to the transaction are not relevant for tax purposes. The only relevant legal fact for taxation is the generated capital gain.<sup>7</sup>

### 3. Hidden Profit Distribution as Fictitious Acquisition?

The most important criterion when determining the intent of tax avoidance is the agreed purchase price. If the purchase price demonstrates a lack of **economic substance**, both the Financial Administration and the court<sup>8</sup> shall determine that the transaction represents a disguised profit distribution.

Hidden profit distribution based on a fictitious share purchase contract between a shareholder and his company pursuant to Personal Income Tax Act<sup>9</sup> shall be taxed as dividends.<sup>10</sup> However, the definition of the term “fictitious contract” by the Supreme Court does not provide a specific answer as to when the contract is fictitious, but only a general guidance, focusing on the intent of the contract. The Supreme Court of the Republic of Slovenia considers that a fictitious contract is one concluded by the parties, without having a serious intention to engage in obligations and acquire rights set out in the contract, but only the intention to demonstrate to the outside world that there is a contract with such content between them.<sup>11</sup>

To illustrate the importance of this issue, mention must be made of the recent investigation by the STA. The STA carried out investigations of such transactions between September 2017 and June 2018 and concluded that more than EUR 2.9 million tax liabilities were additionally incurred. Out of thirteen examinations (nine out of which were self-declared), a considerable majority of them, eleven, were incompliant with law.<sup>12</sup>

<sup>7</sup> Kocbek, Marijan: Umik lastnega poslovnega deleža v d.o.o. – korporacijski, bilančni in davčni vidiki, Podjetje in delo št. 2, 2011, page 217.

<sup>8</sup> See Administrative Court of Republic of Slovenia, Judgement no. I U 769/2017-11 of 17 April 2018

<sup>9</sup> Article 90, Paragraph 4.

<sup>10</sup> Tax base for hidden profit distribution shall be determined based on the comparable market price (Personal Income Tax Act, Article 91).

<sup>11</sup> Judgement No. X Ips 151/2017 of 24 October 2018.

<sup>12</sup> Nadzor FURS glede pridobitve lastnega poslovnega deleža družbe, published 15 June 2018, available at: [https://www.racunovodja.com/clanki.asp?clanek=10215/Nadzor\\_FURS\\_glede\\_pridobitve\\_lastnega\\_poslovnega\\_deleza\\_druzbe](https://www.racunovodja.com/clanki.asp?clanek=10215/Nadzor_FURS_glede_pridobitve_lastnega_poslovnega_deleza_druzbe).

#### **4. Conclusion**

In Slovenia, a natural person's income derived from selling his business share to his limited liability company is generally taxed as a capital gain. This means that the tax rate will be lower for every five years of ownership of a business share.

However, the investigations of the tax authority demonstrate that in many cases such transactions constitute a hidden profit distribution due to the lack of an economic substance to the purchase price. Transactions in these cases fulfil the legal condition for their taxation as a dividend payment, meaning the income from the sale of business share will be taxed at 25%, regardless of how long the shareholder owned the business share. There is currently no jurisprudence of the Supreme Court regarding this matter, so the standpoint of the highest institution of the judicial branch on this issue remains open.

Since there is only a general guideline provided to determine when the acquisition is deemed fictitious, the nature of each acquisition must thus be determined on a case-by-case basis to determine how it is to be taxed.

Author:

Maša Tičar, Intern