



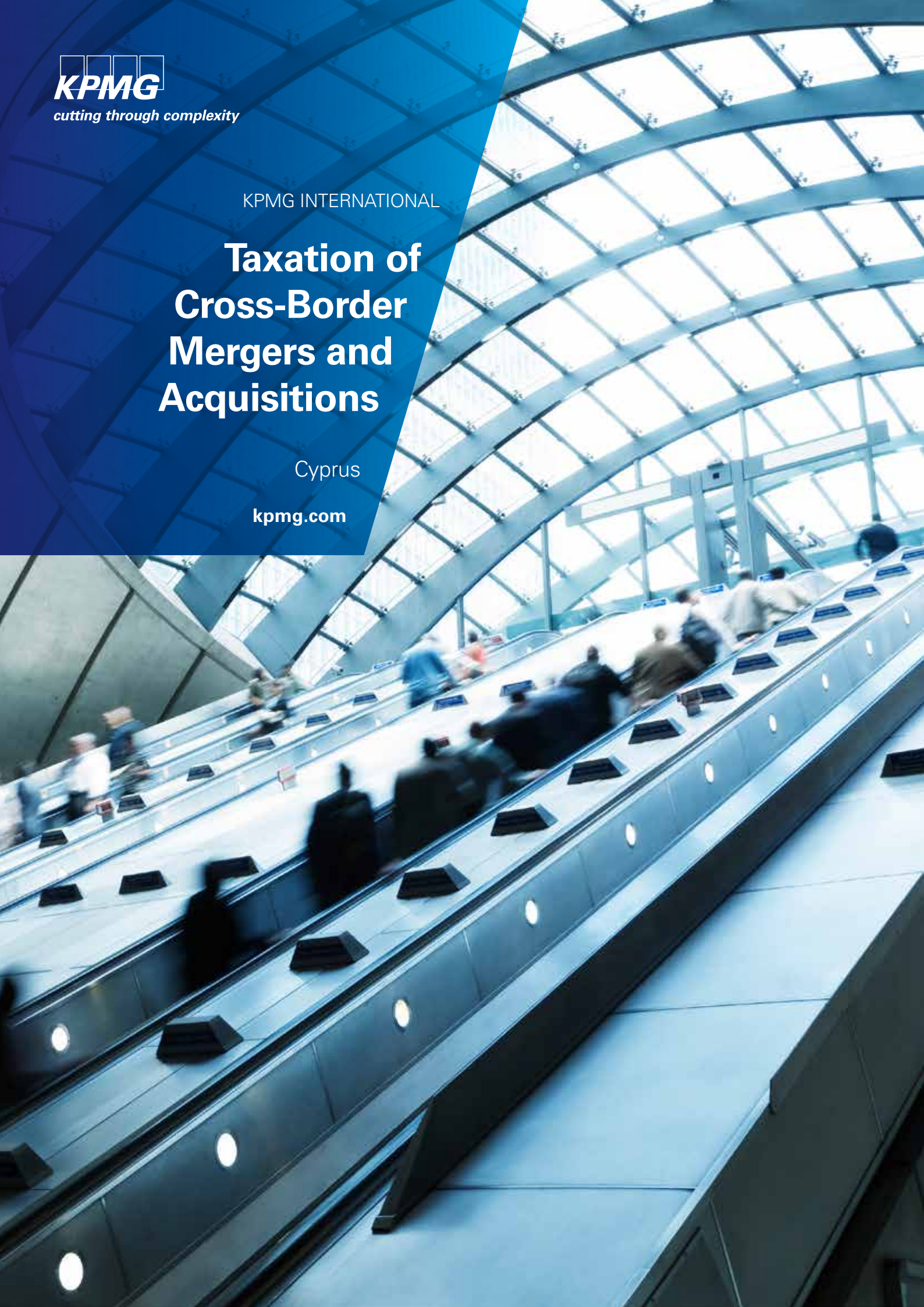
cutting through complexity

KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Cyprus

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Cyprus

Introduction

The Income Tax Law No. 118 (I) 2002 introduced major reforms of Cyprus's tax system at the time of Cyprus's accession to the European Union (EU) on 1 May 2004. The law was designed to modernize and harmonize the Cypriot tax system with that of other European countries and ensure full compliance with:

- European Community law (having eliminated provisions in conflict with EU state aid rules)
- the EU Code of Conduct for Business Taxation and the Organisation for Economic Co-operation and Development (OECD) guidelines to eliminate preferential treatment for international businesses
- all EU Directives.

As a result, the corporate reorganization provisions were incorporated in the income tax legislation. Several other laws, such as the stamp duty and capital gains laws, were also amended to allow the tax-free implementation of these provisions. The reorganization provisions incorporated in the new tax legislation provide for:

- corporate mergers
- corporate divisions
- transfers of assets
- exchanges of shares.

Recent developments

The tax treatment of cross-border mergers and acquisitions (M&A) has remained unchanged since 2009.

However, in the recent years, the Income Tax Law has been amended to include among others:

- an increase in the corporate income tax rate
- the removal of interest deductibility restrictions on equity acquisitions (trading)
- the introduction of a time-bar to the carry forward of losses
- the introduction of a favorable intellectual property (IP) regime.

Tax rates

Individuals are subject to tax at personal income tax rates as follows:

Up to 19,500 Euros (EUR)	0 percent
From EUR19,501 to EUR28,000	20 percent
From EUR28,001 to EUR36,000	25 percent
From EUR36,301 to EUR60,000	30 percent
More than 60,001	35 percent

Companies are subject to tax at the rate of 12.5 percent.

Source: KPMG in Cyprus, 2014

Asset purchase or share purchase

An acquisition in Cyprus usually takes the form of a purchase of the shares of a company, as opposed to its business and assets. There is no capital gains tax on sales of shares or business assets except for capital gains on immovable property in Cyprus and shares in companies the assets of which consist of immovable property in Cyprus.

Gains from sales of shares listed on a recognized stock exchange are exempt from capital gains tax. From a tax perspective, asset acquisitions are likely less attractive for the seller due to the capital gains on immovable property situated in Cyprus, the likely recapture of capital allowances (tax depreciation), transfer fees paid on transfer of immovable property, and possible double taxation on extracting the sale proceeds. However, the benefits of asset acquisitions for the purchaser should not be ignored, particularly given that purchased goodwill attracts a tax deduction. Some of the aspects of each method are discussed later in this chapter.

Purchase of assets

A purchase of assets (excluding real estate assets) usually results in an increase in the base cost of those assets for capital allowances purposes, although the increase is likely to be taxable to the seller. Historical tax liabilities generally remain with the company and are not transferred with the assets.

Purchase price

For tax purposes, it is necessary to apportion the total consideration among the assets acquired. It is advisable for the purchase agreement to specify the allocations, which are normally acceptable for tax purposes provided they are commercially justifiable.

However, there are two rules that affect the allocation of the purchase price. The first stipulates that the value of the trading stocks must equal the amount they would have realized on the open market. The second is that, for capital allowance purposes, the purchaser's cost of acquisition and the seller's disposal proceeds are, in the opinion of the Commissioner of Income Tax, what they would have cost or realized if purchased or sold on the open market.

Goodwill

Where the acquisition price includes goodwill arising from the carrying on of the business, such goodwill is not eligible for capital allowances. However, if the business concern is later re-sold to another person and the sale price includes trade goodwill the value of which is taxable to the seller, the goodwill's original cost to the seller is deducted from the new value of the goodwill sold and any balance is taxable to the seller.

Depreciation

Depreciation of assets charged in the accounts is ignored for tax purposes, but Cyprus tax legislation allows the cost of certain tangible assets (such as plant and machinery, furniture and fittings, and buildings) to be written off against profits at specified rates by means of capital allowances.

As an incentive, lower rates are provided for wear and tear on certain types of plant and machinery and on industrial and hotel buildings acquired during the tax years 2012 – 2014; after 2014, the lower rates will not apply.

Tax attributes

Tax loss capital allowance pools are not transferred on an asset's acquisition. They remain with the company or are extinguished.

Value added tax

Cyprus's value added tax (VAT) legislation is fully harmonized with the EU's Sixth Directive as of 1 February 2002.

VAT is levied at the rate of 18 percent and increased to 19 percent from 13 January 2014 onwards on a large number of goods and services. Goods exported from Cyprus to non-EU destinations are subject to a zero VAT rate. The transfer of a business as a going concern is outside the scope of VAT, provided certain conditions are met. The effect of the transfer must put the new owner in possession of a business that can be operated as such. Thus, a sale of assets is not in itself a transfer of a business as a going concern. If land and buildings are being sold, professional advice should be sought.

Sale of shares

The sale of shares is specifically listed as an exempt transaction in the Cyprus VAT legislation (see Schedule Seven, Table B).

Transfer taxes

No stamp duty is levied on instruments transferring ownership of shares.

Transfers of Cyprus land and buildings are not subject to stamp duty land tax; however, transfer fees on the purchase price or the market value of the property are paid to the Land Registration Office. Transfer fee rates are 3 percent on the first EUR85,430 of the value, 5 percent on the next EUR85,430 of the value, 5 percent on the next EUR85,430 and 8 percent thereafter.

Transactions involved in a reorganization scheme are exempt from stamp duty and land transfer fees.

Purchase of shares

The purchase of a target company's shares does not result in an increase in the base cost of that company's underlying assets; there is no deduction for the difference between underlying net asset values and consideration.

Tax indemnities and warranties

In a purchase of shares, the purchaser takes over the target company together with all its liabilities, including contingent liabilities. Therefore, the purchaser normally requires more extensive indemnities and warranties than in the case of a purchase of assets.

Tax losses

Accumulated, carried forward Cyprus tax losses generated by the target company are transferred along with the company. A company's carried forward loss cannot be set off against the profits of other companies through group relief, but it can be set off against the company's own future profits. Trading losses can be carried forward for up to 5 years from the year to which the profits relate.

Where a Cyprus target company with trading losses is acquired by a company, it may use the losses against its own future trading profits, provided there has been no major change in the nature or conduct of its trade in the period from 3 years before to 3 years after the date of acquisition. If the purchaser intends to substantially change the nature of the target company's business, it may be advisable to wait until at least 3 years have elapsed from the date of acquisition.

Transfer taxes

Stamp duty is payable on the consideration given for shares in a Cyprus company and is calculated on the basis of the consideration stated in the agreement.

Choice of acquisition vehicle

Several potential acquisition vehicles are available to a foreign purchaser, and tax considerations often influence the choice. A capital duty applies on the introduction of new capital to a Cyprus company or branch.

Foreign parent company

The foreign purchaser may choose to make the acquisition itself, perhaps to shelter its own taxable profits with the financing costs. This causes no tax problems in Cyprus, because Cyprus does not tax the gains of non-residents disposing of Cyprus shares and does not levy withholding tax on dividends or interest.

Local branch

As an alternative to the direct acquisition of the target's trade and assets, a foreign purchaser may structure the acquisition through a Cyprus branch. Cyprus does not impose additional taxes on branch profits remitted to an overseas head office. The branch will be subject to Cyprus tax at the normal corporate rate of 1 percent. If the Cyprus operation is expected to make losses initially, a branch may be advantageous; subject to the tax treatment applicable in the head office's country, a timing benefit could arise due to the ability to consolidate losses with the profits of the head office.

Choice of acquisition funding

A purchaser using a Cyprus acquisition vehicle to carry out an acquisition for cash needs to decide whether to fund the vehicle with debt, equity or a hybrid instrument that combines the characteristics of debt and equity.

Deductibility of interest

As a general rule, to ascertain a person's chargeable income all outgoings and expenses wholly and exclusively incurred by such a person (individual or company) in the production of taxable income shall be deducted, including:

- interest paid on loans used to acquire business assets used in the business
- interest incurred on loans used to acquire, improve or maintain a rental asset (in which case the interest is deductible only against the rental income).

Under Cyprus tax law, it is not permitted to deduct any interest expenses related to the acquisition of a private motor vehicle (saloon car) or a non-business asset. However, after the lapse of 7 years from the date of purchase of the relevant asset, the tax authorities stop disallowing any interest as they consider the debt on the acquisition of the asset as paid.

Following an amendment of the Cyprus Law in 2012, any interest expense related to acquisitions of shares after 1 January 2012 may be deducted from taxable income provided that the acquired company is directly or indirectly wholly acquired (i.e. 100 percent shareholding) and the acquired company holds assets used in the business. Other interest expense related to non-business assets is not deductible.

Other considerations

Company law and accounting

The Companies Law CAP 113 as amended (based on the United Kingdom Companies Act 1948) prescribes how Cyprus companies may be formed, operated, reorganized and dissolved. The law governing partnerships in The Partnerships and Business Names Law CAP 116 is also almost identical to that of the United Kingdom (UK).

Cyprus case law has been developed significantly since 1960. In the absence of Cypriot case law on particular legal issues, the court looks to UK case law, which, although it may not be binding, is persuasive authority.

Cypriot companies may be private companies limited by shares, public companies limited by shares, companies limited by guarantee, or branches of overseas companies.

There are no requirements related to the minimum authorized capital of a private limited liability company by shares (CyCo) and such a company may have, as issued share capital, as few as one share.

The Companies Law requires companies to prepare complete financial accounts, which in their entirety should conform to International Financial Reporting Standards (IFRS).

The Companies Law allows mergers, reorganizations and cross-border mergers of Cyprus companies with companies having their registered office within EU. Cyprus has adopted in its totality the EU Directive 2005/56 on cross-border merger of limited liability companies. Tax laws incorporate provisions for tax-free corporate reorganizations in line with the EU Directive. The various forms of permissible reorganizations are described below.

Merger

- One or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issuance of shares to their shareholders representing the capital of the other company, and, if applicable, in exchange for a cash payment not exceeding 10 percent of the nominal value of the shares, or in the absence of a nominal value, of the accounting par value of those shares.
- Two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a new company that they form, in exchange for the issuance of shares to their shareholders representing the capital of that new company and, if applicable, in exchange for a cash payment not exceeding 10 percent of the nominal value of the shares, or in the absence of a nominal value, of the accounting par value of those shares.
- A company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the shares representing its capital.

Division

A division is defined as an operation whereby a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new companies in exchange for the pro rata issuance of shares to its shareholders representing the capital of the companies receiving the assets and liabilities and, if applicable, in exchange for a cash payment not exceeding 10 percent of the nominal value of the shares, or in the absence of a nominal value, of the accounting par value of those shares.

Partial division

A partial division is defined as an operation whereby a company, without being dissolved, transfers one or more branches of activity to one or more existing or new companies, leaving at least one branch of activity in the transferring company, in exchange for the pro rata issuance of securities to its shareholders representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 percent of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities.

Transfer of assets

A transfer of assets is defined as an operation whereby a company transfers, without being dissolved, all or one or more branches of its activity to another company in exchange for the transfer of shares representing the capital of the company receiving the transfer.

Exchange of shares

An exchange of shares is defined as an operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company, in exchange for the issue to the shareholders of the latter company, in exchange for their shares, shares representing the capital of the former company and, if applicable, in exchange for a cash payment not exceeding 10 percent of the nominal value of the shares, or in the absence of a nominal value, of the accounting par value of those shares.

Group relief/consolidation

Two companies are deemed to be members of a group if:

- one is a 75 percent-owned subsidiary of the other
- each is a 75 percent-owned subsidiary of a third company.

The tax legislation includes detailed rules for determining whether a company is considered a 75 percent-owned subsidiary of another company.

The set-off of losses is only allowed where the surrendering and claimant companies are members of the same group for the whole year of assessment.

For purposes of corporation tax, losses within the group companies can offset the total chargeable corporate income in the corresponding year of assessment only. In computing the loss that may be surrendered, no amount of loss brought forward from a previous year shall be taken into account.

Transfer pricing

If, following an acquisition, an intercompany balance arises between the purchaser and the target, failure to charge interest on the balance may give rise to transfer pricing problems in the relevant jurisdiction. For example, where the balance is owed to the target company, the Cyprus tax authorities could invoke the provision of the Income Tax Law to impute interest on the balance, if an arm's-length interest rate is not charged.

Foreign investments of a local target company

Participation exemption legislation offers an incentive to Cyprus companies, or a company that is not a resident of Cyprus but has a permanent establishment in Cyprus, as dividend income received from abroad is tax-exempt. This exemption does not apply if more than 50 percent of the direct or indirect activities of the company paying the

dividends leads to passive income (non-trading income) and the foreign tax burden on the income of the company paying the dividends is substantially lower than the Cyprus tax burden (an effective tax rate of at least 5 percent in the country paying the dividend satisfies this condition).

Comparison of asset and share purchases

Advantages of asset purchase

- The purchase price (or a proportion not including goodwill) can be depreciated for tax purposes.
- A step-up in the cost base for capital gains tax purposes (where applicable) is obtained.
- No previous liabilities of the company are inherited.
- Possible to acquire only part of a business.
- Greater flexibility in funding options.

Disadvantages of asset purchases

- Additional legal formalities apply in areas such as notification of suppliers and change of name.
- Where only assets are purchased, the initial price is higher.
- Tax losses are not acquired.
- Complications may result from rules on the allocation of the purchase price on the purchase of an enterprise.

Advantages of share purchases

- Attractive to sellers since it is exempt from corporate taxation.
- It may be possible to use tax losses, subject to conditions.
- Contracts with suppliers, employees, etc. automatically transfer.
- There is no real estate transfer tax.

Disadvantages of share purchases

- Possible restrictions on interest deductibility where the enabling conditions are not met.
- Buyer inherits all undisclosed liabilities of the target company.
- Higher tax liability will apply on the future disposal of assets due to the lower cost base.

Cyprus – Treaty withholding rates

This table sets out reduced withholding tax rates that may be available for various types of payments to non-residents under Cyprus's tax treaties. This table is based on information available up to 10 January 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends ¹		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
Domestic Rates				
<i>Companies:</i>	0	0	0	0/5/10
<i>Individuals:</i>	0	N/A	0	5/10
Treaty Rates				
<i>Treaty with:</i>				
Armenia	5	0	5	5
Austria	10	10	0	0
Belarus	15	5/10	5	5
Belgium	15	10	10	0
Bulgaria	10	5	7	10
Canada	15	15	15	0/10 ³
China (People's Rep.)	10	10	10	10
Czech Republic	5	0	0	10
Denmark	15	0	0	0
Egypt	15	15	15	10
Estonia ²	0	0	0	0
Finland ²	15	10	0	0
France	15	10	0/10	0/5 ⁴
Germany	15	5	0	0
Greece	25	25	10	0/5
Hungary	0	0	0/10	0
India	15	10	0/10	15
Ireland	0	0	0	0/5
Italy	0	0	10	0
Kuwait ²	0	0	0	0/5 ⁶
Lithuania ⁹	5	0	0	5
Lebanon	5	5	0/5	0
Malta	15	15	0/10	10
Mauritius	0	0	0	0
Moldova	10	5	5	5

	Dividends ¹		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
Montenegro ⁶	10	10	10	10
Norway	0	0	0	0
Poland	5	0	5	5
Portugal ²	10	10	10	10
Qatar	0	0	0	5
Romania	10	10	0/10	0/5 ⁶
Russia	10	5	0	0
San Marino	0	0	0	0
Serbia ⁷	10	10	10	10
Seychelles	0	0	0	5
Singapore	0	0	0/7/10	10
Slovak Republic	10	10	10	0/5 ⁶
Slovenia	5	5	0/5	5
South Africa	0	0	0	0
Sweden	15	5	10	0
Syria	5	0	0/10	10/15 ⁶
Thailand	10	10	10/15	5/10/15 ⁸
Ukraine ²	0	0	0	0
United Arab Emirates ⁹	0	0	0	0
United Kingdom	0	0	10	0/5 ⁵
United States	0	0	0/10	0

Notes:

- The different rates in these columns are not explained because, under Cypriot law, no tax is withheld on dividends and interest, even where a treaty allows such a tax.
- New Treaty effective as of January 1, 2014.
- The lower rate applies to copyrights on literary, dramatic, musical and artistic works, excluding films.
- The zero rate applies (i) if the recipient company owns directly at least 10 percent of the capital of the Cypriot company for an uninterrupted period of at least one year; (ii) to dividends paid to public bodies; and (iii) to dividend paid to a pension fund or other similar institution, where such pension fund or the institution is established, recognized for tax purposes, and controlled in accordance with the laws of Denmark.
- The rate is 5 percent on films, etc.
- The lower rate applies to copyrights on literary, artistic and scientific works, including film and television royalties.
- The treaty was concluded between Cyprus and former Yugoslavia.
- The 5 percent rate applies to artistic and scientific copyrights, including software, films, etc.; the 10 percent rate applies to equipment leasing and know-how; the 15 percent rate applies to patents, trademarks, designs or models, plans, secret formulae or processes.
- Signature Phase/Pending completion of ratification process.

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