By Elias Neocleous, Elias Neocleous & Co LLC

TAXATION IN M&A

About Elias Neocleous
Elias Neocleous, Managing Partner, is a recognised authority on Cyprus taxation and trusts and is frequently invited to participate as a speaker or chairman at international tax conferences, alongside other leading experts. Elias has many distinguished publications to his credit in the field of corporate and tax law, and is the Cyprus country correspondent for "Trusts and Trustees". Operating out of offices in the three main business centres of Cyprus, being Limassol, Nicosia and Paphos, coupled with an international network in key centres of Prague, Budapest, Kiev and Brussels, the firm has strategic and geographic coverage ensuring the ability to efficiently meet the fast-paced modern demands of our clients in all their national and cross border transactions and disputes.

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What is a taxable merger?

A merger will be considered as a taxable merger if at least one of the parties involved in the merger is liable to taxation.

What are the taxation risks associated with mergers and acquisitions?

The applicable law in Cyprus in relation to taxation on mergers and acquisitions is the Income Tax Law (118(I) 2002) (the "Law"), specifically Part VI, which provides guidance in relation to taxation on restructuring. As per the provisions of the law, a restructuring is defined so as to include,inter alia, mergers.

In 2015, the Law was amended with the introduction of anti abuse rules providing that - in cases where the Commissioner of Income Tax is not satisfied -, there is commercial rationale behind the restructuring; it also concludes that if the main purpose of the restructuring was to get tax exemption, then no exemption from tax on profits arising as a result of restructuring will be granted (since profits resulting from the restructuring are tax exempt). Therefore, the taxation risks related to mergers and acquisitions is that tax exemption will be denied if the merger in question is not genuine with economic and commercial rationale. This is in line with the provisions of the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting ("MLI") aiming at combating artificial arrangements and Base Erosion and Profit Shiting ("BEPS") Action Plan 6 on 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances'. Jurisdictions are obliged to implement one of the anti abuse measures provided by the MLI and BEPS Action 6; Cyprus has chosen to adopt the principal purpose test ("PPT") which provides that, in cases where the principal purpose of a transaction is to obtain a tax benefit, then the said arrangement will be ignored and the said benefits will, therefore, not be granted.

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How can companies avoid these risks from occurring?

Companies should ensure that their transaction is genuine, commercially justifiable and is in the best interests of the group and companies involved and on an arm's length basis.

In relation to tax losses, which are transferred to the receiving company (also expanded below) there is a risk that those losses will not be used against the receiving company's future trading profits if there has been a major change in the nature or conduct of its trade in the period from three years before, up to three years after the date of the acquisitions as stated in Article 13 of the Law . Therefore, if the buyer intends to substantially change thenature of the target company's business, it may be

advisable to wait until at least three years after the date of acquisition.

What tax incentives can increase a firm's interest to merge/invest?

In general, the profits resulting from the restructuring are tax exempt.

Assets and liabilities, including forecasts and reserves that are transferred through a reorganisation, do not generate taxable profits on the transferor. The recipient company, - and in the case of a merger, the surviving company -, shall calculate new depreciation and any gains or losses on transferred assets and liabilities, or forecasts and reserves, in accordance with the terms of the transferee or companies as if no reorganisation took place. In the event of a reorganisation involving companies either resident or not in the Republic, any accumulated losses of the transferee who is resident in the Republic or has a permanent establishment in the Republic, shall be transferred to the receiving company which may either be a resident or not of the Republic but has a permanent establishment in the Republic. In this case, the provisions relating to the offsetting or transfer of losses will apply according to the accumulated; the carried forward Cyprus tax losses generated by the target company (the company that will be acquired), are transferred along with the target 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 five years from the year to which the profits relate. Where a Cypriot target company with trading losses is acquired by the receiving 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 three years before up to three years after the date of acquisition. Finally, as per the provisions of the Stamp Duty Law, transactions under restructuring are exempt from stamp duty.

Are there any tax regulations unique to Cyprus which makes appeals to firms wanting to merge?

Cyprus has fully adopted the EC Merger Directive and therefore, where a transaction is a "reorganisation", it is exempt from corporate income tax, capital gains tax, stamp duties and property transfer fees.

Cross-border and domestic mergers, are generally tax neutral as aforementioned. Additionally, there is no Cypriot "exit taxation" applied to such restructurings. However, Cyprus will adhere to the provisions of the Anti-Tax Avoidance Directive ("ATAD") on exit taxation, which will enter into effect as from January 2020. This tax will be triggered, inter alia, on a change of domicile or tax residency of a taxpayer from Cyprus to another jurisdiction and is usually applied on unrealised capital gains. However, the Cyprus tax authorities are yet to issue any draft bills on how the provisions of the ATAD on exit taxation will be implemented into Cypriot law. **LM**

Elias Neocleous & Co LLC
Elias Neocleous & Co LLC is among the largest firms in South East Europe and the Eastern Mediterranean, with more than 150 lawyers, tax consultants and other professionals. All are English-speaking and members of staff speak most European languages, as well as major Asian languages. The firm is generally regarded as a regional leader, with a particular forte in cross-border work, advising international clients on all aspects of Cyprus and European law and handling the largest and most demanding cross-border assignments. The difference is not merely one of size, but also relates to specialisation, strength in depth and the capacity to deal with complex and urgent assignments at short notice, while providing world-class standards of responsiveness and quality. Operating out of offices in the three main business centres of Cyprus, being Limassol, Nicosia and Paphos, coupled with an international network in key centres of Prague, Budapest, Kiev and Brussels, the firm has strategic and geographic coverage ensuring the ability to efficiently meet the fast-paced modern demands of our clients in all their national and cross border transactions and disputes.

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