CYPRUS

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

The most recent developments which are relevant to M&A deals and private equity relate to the following:

- Introduction of a number of anti-avoidance provisions which give the right to the Tax Commissioner to refuse tax neutral reorganisations if the Commissioner is: (i) not satisfied that there were genuine commercial or financial reasons for such reorganisation and (ii) if he can demonstrate that the main purpose of the reorganisation is the reduction, avoidance or deferment of payment of taxes. In practice, the Commissioner can deny a tax neutral reorganisation if he judges that the main purpose or one of the main purposes of the re-organisation was i) the avoidance, decrease, or postponement of the payment of tax, or ii) the direct or indirect allocation of an entity's assets to a person without settling the corresponding tax, or as a means of decreasing/postponing that corresponding tax
- Immovable property taxes abolished as of 1 January 2017
- Transfer pricing legislation came into effect as of 1 July 2017 with respect to back-to-back financing arrangements, whilst legislation for other transactions is also expected to be announced

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

A number of changes have already been introduced in Cyprus as a result of the OECD BEPS Actions. In regard to Plans 6 and 15, Cyprus signed the multilateral instrument on 7 June 2017.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

A) Share deal

By an acquisition of shares, no direct taxes are triggered for the buyer. In situations where the relevant share purchase agreement is found to be subject to stamp duty in Cyprus, the tax obligation rests with the buyer, unless the contract provides otherwise. Of course, a contract is exempt from stamp duty when the acquisition is affected as a result of company re-organisation.

The stamp duty varies from nil to 0.20% and is capped at €20,000.

B) Asset deal

By the acquisition of immovable property, the buyer is liable for a transfer fee. Transfer taxes range from 3% to 8%, depending on the value of the property. The tax is:

- 3% on amounts up to €85,000 of the sale price or market value
- 5% on amounts between €85,001 and €170,000
- 8% on any amount exceeding €170,000

The above transfer fees are reduced by 50% in case the purchase of immovable property is not subject to VAT.

Immovable Property Tax is abolished as of 1 January 2017. Until tax year 2016, the owner of immovable property situated in Cyprus was liable to pay an annual immovable property tax which was calculated on the market value of the property as at 1 January 1980, at the varying rates, which applied per owner and not per property.

Again, the agreement for the acquisition of immovable property or any other asset may also be subject to stamp duty in Cyprus. Stamp duty is imposed on contracts relating to assets located in or "things" to be done in Cyprus. If the provisions of a reorganisation are applied, as defined under Cypriot law (which is in line with the provisions of the EU Merger Directive), such a purchase can be tax neutral. Depending on the nature of the assets transfer fees may apply.

The purchase of a company's assets — unlike the purchase of shares — may be subject to VAT, which is currently rated at 19%.

In terms of utilisation of tax losses, tax losses are not available for set-off in the case of a share deal and given that profits from the sale of shares are generally exempt from tax.

In the case of a taxable sale of immovable property, any losses realised may be set off against similar profits that may arise in the future. The same principle applies to gains and losses resulting from the sale of other assets – where gains are taxable, the deductibility of losses may be allowed.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

A re-evaluation of assets can be affected via an independent valuator. Any increase or decrease in the value of assets is reflected accordingly.

The increase in value is recorded as a capital reserve. Generally, there is no tax obligation with respect to that reserve. However, depending on the nature of the assets, corporation tax or capital gains tax may be imposed in the case of sale.

5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?

Goodwill is not subject to depreciation or amortization. Since Cyprus applies International Financial Reporting Standards (IFRS), goodwill is tested for impairment (comparing recoverability with the carrying amounts) annually or whenever there is an indication of a possible reduction in value.

For impairment testing, goodwill is allocated to the relevant cash-generating unit (the lowest level within the entity for internal management purposes) and this cash-generating unit is tested for impairment.

Impairment loss on goodwill cannot be carried back.

Goodwill does not appear on individual statutory statements, it only appears in consolidated financial statements. The goodwill is treated as a fixed asset and, as such, gains are excluded from tax.

6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

According to Cypriot tax law, expenses may be deducted if they have been incurred wholly and exclusively to produce income. In line with this, interest paid on a loan that has been used or will be used by the company for trading purposes or for the acquisition of trading fixed assets is fully deductible. Also, following an amendment to the Cyprus Law in 2012, any interest expense relating to the acquisitions of shares after 1 January 2012, may be deducted from taxable income on the provision that the acquired company is directly or indirectly wholly acquired, i.e. 100% shareholding, and the acquired company holds assets which are all used for business purposes.

On the other hand, any other interest income not classified as part of trading or related to company's trading activities may not be treated as a deductible expense.

Overall, under the Cyprus tax law, it is not permitted to deduct any interest expenses relating to the acquisition of a non-business asset. Additionally, after the lapse of seven years from the date of purchase of an asset, the Cyprus Tax Office stops disallowing any interest as it considers the debt on the acquisition of the asset as paid.

Interest limitation rules in accordance with the Anti-Tax Avoidance Directive are expected to come in effect within the timeframes set by the European Union.

7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN DEBT ON ACQUISITIONS?

With a properly designed tax structure, debt push-down can be easily achieved.

Cypriot Companies law has an absolute prohibition on financial assistance given by a company whether directly or indirectly, for the purchase or subscription of its own, or its holding company's shares. In line with this, in a transaction with multiple dealings, share acquisition financing may not be linked to debt push-down, given that this may be treated as an indirect financial assistance. However, express exclusions from the scope of this provision are included in the law. The application of the provisions of EU Merger Directive incorporated into Cypriot law may prove to be beneficial in achieving debt push-down. An intermediary company may be incorporated in order to acquire the target. The intermediary company can subsequently be merged with the target company.
To implement this plan, proper advice should be sought. Especially considering the latest tax developments, which outlined "substantial activity" as a core element for tax free reorganisations. Generally, if the structure and the transaction have sufficient underlying substance, any risks of avoiding taxation are effectively minimised.

Deferment of the debt (i.e. debt to be carried forward by postponing the payment of liability to the future) is also possible, allowing allocation of obligations.

From a Cypriot perspective, any losses that would have been subject to tax if they were to be gains may be off-set against other sources of income in the same tax year. When the income is not sufficient, the losses may be carried forward and off-set against profits in subsequent years. In the case of change of ownership of a company, as well as change in the nature of the activities of a company, previous losses may not be carried forward and used by the new owners. A company may also surrender tax losses to another company from the same group (specific criteria exist for group loss relief involving foreign entities).

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In 2015, Cyprus introduced Notional Interest Deduction ('NID') in its tax law, which relates to a notional interest deduction on new equity which can be set against taxable income generated by the company as a result of the funds from the new equity.

NID is equal to the interest yield of the 10-year government bond yield of the country in which the new equity is invested increased by 3% (the minimum rate being the yield of the Cyprus 10-year government bond increased by 3%). The bond yield rates to be used are those of December 31 of the year preceding the assessment year. The notional interest to be deducted cannot exceed 80% of the taxable income of the company for the year before the deduction of this notional interest

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?

Tax losses incurred in any one year that cannot be wholly offset against other income may be carried forward for five years and set off against profits resulting in subsequent years.

However, according to the law, losses incurred by a company cannot be carried forward if:

- Within any three-year period, there is a change in the ownership of the shares of a company and a substantial change in the nature of the business of the company (a significant change can be interpreted as a drastic change in the types of activities offered by a company - i.e. originally sells computers and then stops to commence trading in pharmaceuticals)
- At any time since, the scale of the company's activities has diminished or has become negligible and before any substantial reactivation of the business there is a change in the ownership of the company's shares

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

No such items that are very specific to Cyprus exist. All standard items should be included.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

Stamp duty at nominal rates is payable on a variety of legal documents and may apply in the case of a transfer of shares. Specifically, stamp duty is governed by the Stamp Duty Law (19/1963), within which article 4 (1) provides that the documents specifically presented in its first schedule are subject to stamp duty if these documents concern property situated in the Republic of Cyprus, as well as matters or things to be performed or done in Cyprus, irrespective of the place of execution of such documents. Agreements for the purchase of shares in a Cypriot company, which are executed in Cyprus, are not required to be stamped in Cyprus, and it is also the actual practice of the Stamp Duty Commissioner to exclude and exempt such documents from stamp duty. Further, not required to be stamped in Cyprus are: i) instruments of transfer of shares in a Cypriot company which are executed in Cyprus ii) agreements for the purchase of the shares in a foreign company which are executed in Cyprus, and iii) instrument for the transfer of shares in a foreign company which are executed in Cyprus.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

A purchaser making use of a Cyprus acquisition vehicle in order to execute an acquisition for cash can fund the vehicle with debt, equity, or hybrid instruments that combine the characteristics of debt and equity together. Further after, as a general rule, in order to ascertain a physical or legal person's chargeable income, only the outgoings and expenses which are wholly and exclusively incurred by such a person in the production of taxable income can be allowed to be deducted.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

The Cyprus value added tax law is fully harmonised with the EU Sixth Directive.

In particular, the transfer of a business as a going concern is outside the scope of VAT, provided certain conditions are met. The actual end-result of such transfer needs to be that a new owner is established who will be operating the business as such. Therefore, the mere sale of assets does not constitute in itself a transfer of a business as a going concern. While in the case that land and buildings are sold, it is advised that professional consultancy is requested.

As for the sale of shares, it is specifically listed as an exempt transaction in the Cyprus VAT law via Schedule Seven, Table B of the relevant legislation.

On this note, as sales of shares is categorised as 'exempt', no [input] VAT tax incurred on related costs, such as professional fees, is eligible to be recovered.

Yet, following the European Court of Justice [ECJ] decision to Kretztechnik AG v Finanzamt Linz (Case C-465/03), input VAT tax incurred in relation to the issue of shares instead, can be generally recoverable. Specifically, if a buyer issues shares in consideration of an acquisition, some or even all of the VAT attributable to the corresponding share issue can be considered recoverable.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

Cyprus is renowned as a jurisdiction for holding companies. In the majority of cases, its domestic legislation allows a tax-free treatment of incoming dividends from foreign subsidiaries. It also allows the distribution of dividends to the non-resident shareholders free from withholding taxes. Equally, from a financing perspective, any interest payments to non-residents can also effectively be free from withholding taxes.

In any case, transactions between the Cypriot company and other group companies should follow transfer pricing regulations. In Cyprus, transfer pricing regulations are fairly limited, but are expected to soon become more extensive. Specifically, as of 1 July 2017, transfer pricing rules were introduced in relation to back to back loan arrangements.

Further, in an aim and effort by Cyprus to always treat transactions between related parties in a fair way, a December 2015 tax law amendment, which is effective retroactively from 1 January 2015, was introduced in reference to the arm's length principle as codified in the tax law. As per this, a negative transfer pricing adjustment is now included within the provisions, while prior to that, the law only provided for upward adjustments in cases when transactions between related parties were not performed at arm's length.

Further on, to mitigate tax effects, in the cases of acquisitions, an important parameter that should be taken into consideration is the provisions of the relevant agreement for avoidance of double taxation (if any) between Cyprus and the country in which the subsidiary and / or parent will be located.

Any additional specific issues to be considered in the case of acquisitions of Cyprus companies by foreign investors, will need to be also examined on a case by case basis, depending on industry sector involved and investor's jurisdictional origin.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL MANNER THROUGH MERGERS OR A TAX GROUPING?

Cyprus has implemented the provisions of the EU Merger Directive in its national income tax legislation, enabling tax-neutral reorganisations.

According to Cypriot law, the transfer of assets and liabilities in the course of reorganisation does not give rise to any taxable profits at the level of the transferring company. Accumulated losses of the transferring company moved to the receiving company may be off-set and the relevant provisions for the consolidation of losses are applied. Equally profits derived at the level of the receiving company as a result of the cancellation of its participation in the transferring company do not give rise to any taxable obligations. The issue of shares in the receiving company to the shareholder of the transferring company in consideration of shares in the transferring company does not give rise to any taxation on the gains or losses at the level of the shareholder. In order to qualify for tax exemption, the corporate reorganisation should not involve a cash payment exceeding 10% of the nominal value of the shares.

As of 1 January 2016, new anti-abuse and anti-avoidance provisions in the Cypriot legislation took effect, maintaining and safeguarding the tax neutrality for bona fide transactions.

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

According to Cypriot tax legislation, a capital gains tax at the rate of 20% may be triggered by the sale of shares in companies that derive their value from real estate situated in Cyprus, unless these are first acquired between 16 July 2015 and 31 December 2016. In the case though that capital gains tax is imposable, possible application of a Double Taxation Treaty (DTT) should be considered, especially when the treaty includes favourable provisions for the taxation of capital gains. Capital gains tax will be triggered only when such shares derive their value from real estate situated in Cyprus.

The capital gains tax is not extended to immovable property situated outside Cyprus. Therefore, when a Cypriot company acquires a foreign subsidiary owning real estate situated outside Cyprus, and in turn sells the shares of that subsidiary, no taxes should be triggered in Cyprus. In some cases, DTT allows for the taxation of such gains at the level of the subsidiary.

Acquisition of real estate property by non-Cypriot residents, other than those coming from EU countries, requires the approval of the Ministry of Interior, a process which takes between one and four months.

In the case of a transfer of immovable property, applicable transfer taxes are a liability of the buyer. Transfer taxes are rated between 3% and 8% (whilst certain discounts and exemptions exist).

It should also be noted that as of 1 January 2017 immovable property taxes in Cyprus have been abolished.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

There are provisions for group relief whereby the current year's trading losses of a Cyprus company can be transferred to be set off against taxable profits of another Cyprus company provided both companies were members of the same group for the whole year of consideration. As of 1 January 2015, a Cyprus tax resident company may also claim the tax losses of a group company that is tax resident in another EU member state, provided such EU company firstly exhausts all possibilities available to utilise its losses in its EU member state of residence or in the EU member state of any intermediary EU holding company.

For VAT purposes, two or more companies belonging in the same group of companies may have group registration (a group exists where one company controls the others, or one person controls them all).

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

The Cyprus patent box is fully in line with the recommendations of Action 5 of the Organisation for Economic Co-operation and Development (OECD). Under the patent box, qualifying intangible assets refer to assets that were acquired, developed or exploited by a person in the course of his business (excluding intellectual property associated with marketing) and which pertains to research and development activities for which economic ownership exists. Specifically, these assets are:

- Patents as defined in the Patents Law
- Computer Software

- Other IP assets that are non-obvious, novel and useful, where the person which utilises them in further development of a business that does not generate annual gross revenues exceeding Euro 7.500.000 (or Euro 50.000.000 for a group of companies) and which should be certified by an appropriate authority either in Cyprus or abroad
- Utility models, intellectual property assets which provide protection to plants and generic material, orphan drug designations and extensions of protections of patents, all of which should be legally protected

Qualifying profits (income) is calculated as the proportion of the total income which relates to the fraction of the qualifying expenditure as well as the uplift expenditure which was incurred for the qualifying intangible asset. Such income, for example, consists of royalties in connection with the use of the qualifying intangible asset, capital gains arising on the disposal of a qualifying intangible asset etc.

The overall income is calculated as the total income arising from the qualifying intangible asset within a specific tax year reduced by the direct costs for generating this income.

As with the previous IP Box Regime, 80% of the overall income as defined above is treated as a deductible expense, and in the same manner in the case of losses only 20% of the loss can be carried forward or be surrendered for the purpose of group loss relief.

Qualifying expenditure for a qualifying intangible asset relates to the total research and development costs incurred in any tax year wholly and exclusively for the development, improvement or creation of qualifying intangible assets and where costs are directly related to the qualifying intangible assets.

Examples of such qualifying expenditure includes wages and salaries, direct costs relating to the research and development, including costs which have been outsourced, supplies related to research and development, installations used for research and development etc.

An uplift expenditure is added to the above mentioned qualifying expenditure which is the lower of:

- 30% of the eligible costs
- The total amount of the cost of acquisition and outsourcing to related parties aimed at research and development in connection to the eligible intangible asset

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

No such adverse tax consequences.

SELL-SIDE

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

Capital Gains Tax is imposed (when the disposal is not subject to income tax) on gains from disposal of immovable property situated in Cyprus including shares of companies not listed on a recognised Stock Exchange which own immovable property situated in Cyprus, at the flat rate of 20%. Further, as per recent amendment to the relevant law, as from 17 December 2015 the definition of ‘property’ is extended so that Capital Gains Tax is also levied on sale of shares which directly or indirectly participate in other companies that in turn hold immovable property in Cyprus, on the provision that at least 50% of the market value of the shares that are sold is derived from that Cyprus immovable property.

Further, a favorable exemption is also in place as from July 2015, as per which gains derived from the sale of immovable property is 100% exempted from Capital Gains Tax when i) they were/will be acquired between the day the new law came into effect being 16 July 2015, up to 31 December 2016 inclusively, and ii) they were acquired from an independent non-related party at market value, via an ordinary purchase / purchase agreement, and not through: a donation, or gift, neither by way of exchange, trade nor in a way of settlement of debt, and the sale must not be related to any foreclosure agreement either.

No special treatment for gains arising in M&A context.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS ARE REINVESTED?

There is no fiscal advantage in Cyprus in re-investing proceeds from a sale. The proceeds from the sale of shares are generally exempt from tax, and as such, no tax obligations are anticipated to arise, while gains deriving from the sale of assets would be taxed accordingly.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

Maintenance of sufficient level of taxation is of very high importance. Economic substance is needed not only for obtaining tax residency certificates, but also for application of double tax treaties used for cross-border transactions. Each structure would require a distinctive approach and a differing focus on corresponding relevant matters required for each. However, as an all-purpose note, the following are some common characteristics of substance for Cyprus companies, namely, holding structures: qualified personnel, director; real physical presence in Cyprus, whether through an owned distinct office or via leasing space at a serviced business center; owning at least one bank account maintained with a Cyprus bank, and operated by a Cypriot member of the Board of Directors; maintaining proper accounting books and records in Cyprus, and preparing timely annual Audited Financial Statements, submitting promptly all annual tax returns, and settling promptly all relevant tax amounts due; diversification of investments held by Holding co; public listing; and other characteristics determined case-by-case.

23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Any type of reorganisation does not bear any tax implication in Cyprus, provided that a valid commercial reason for the reorganisation exists. Specifically:

- Assets transferred in a scheme of reorganisation do not give rise to any taxation to the transferring company
- Any accumulated losses of the transferring company are transferred to the receiving company and the provisions of section 13 regarding set-off or carry forward of losses apply accordingly
- No capital gains tax is payable as a result of a transfer of chargeable assets (immovable property or shares in company holding immovable property) until a subsequent sale of the immovable property. In the case of such a subsequent sale, the original base cost will be used to determine the tax payable
- Stamp duty is avoided in case of transactions involved in an approved reorganisation scheme
- Land transfer fees are not due on transfers of immovable property from one company to another, under an approved reorganisation scheme
- Mortgage fees are not due in case a mortgage is transferred from one company to another under an approved reorganisation scheme

A number of anti-avoidance provisions have been introduced which give the right to the Tax commissionaire to refuse tax neutral reorganisations if the Commissioner is (i) not satisfied that there were genuine commercial or financial reasons for such reorganisation and (ii) if he can demonstrate that the main purpose of the reorganisation is the reduction, avoidance or deferment of payment of taxes. The decision of the Tax Commissioner not to grant tax exemption on the reorganisation must be fully justified and the taxpayer has the right to file an objection.

The Commissioner who assesses the tax neutral reorganisation request has the right to impose conditions on the number of shares that can be issued as part of the reorganisation and the period for which such shares should be held by the recipient of the shares, which period cannot exceed three years. Such restrictions cannot apply in the case of publicly listed companies and transfers of shares as a result of succession.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

Employees relocating to Cyprus have two tax incentives. Namely:

- 50% exemption of the remuneration exceeding EUR 100.000 per annum derived from any office or employment exercised in Cyprus by an individual. This exemption is granted for a total period of ten years and is applicable only 50% exemption of remuneration exceeding EUR 100.000 per annum from any office or employment exercised in Cyprus by an individual
- An exemption equal to the lower of (a) 20% of the remuneration derived from any office or employment exercised in Cyprus by an individual and (b) EUR 8.550. This exemption is granted for a total period of five years and will expire in 2020

It is not possible to obtain benefit under both exemptions.

In regard to the sale of a company, any profit arising on the disposal is exempt from taxation in Cyprus, provided that the titles disposed fall within the definition of a title as included in the relevant Circular issued by the Cyprus tax authorities.

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