



MERGERS AND ACQUISITIONS

# Cyprus

Taxation of Cross-Border  
Mergers and Acquisitions

2010 Edition

TAX

# Cyprus

## Introduction

The New Income Tax law No.118 (I) 2002 was a major reform of Cyprus's tax system at the time of Cyprus's accession to the European Union (EU) European Union on May 1, 2004, 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 Organization for Economic Cooperation and Development (OECD) guidelines to eliminate preferential treatment for international businesses; and
- 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, also had to be amended, to allow the tax free implementation of these provisions. The reorganization provisions incorporated in the new tax legislation provide for the following:

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

## Recent Developments

The following summarizes developments in the tax treatment of cross-border mergers and acquisitions (M&A) up to the end of July 2009.

The Income Tax Law has been amended to include:

- transfers of the registered office from one member state to another member state of European companies (SE) and European cooperative societies (SCE);
- partial division; and
- exchanges of shares.

## Tax Rates

As from the year of assessment 2007, the tax rates are as follows:

Up to EUR 19.500	nil
from EUR 19.501 to EUR 28.000	20 percent
from EUR 28.001 to EUR 36.000	25 percent
from EUR 36.301 and onwards	30 percent

## 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, although there is no capital gains tax on sales of shares or business assets except 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, 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 are all likely to make an asset acquisition less attractive for the seller. However, the benefits of asset acquisitions for the purchaser should not be ignored, particularly given that purchased goodwill attracts a tax deduction. Some of aspects of each method are discussed later in the chapter.

## Purchase of Assets

A purchase of assets will usually result in an increase in the base cost of those assets for capital allowances purposes, although the increase is likely to be taxable in the hands of the seller. In addition, historical tax liabilities generally remain with the company and are not transferred with the assets.

## Purchase Price

For tax purposes, it will be necessary to apportion the total consideration among the assets acquired. It is advisable for the purchase agreement to specify the

allocations, which will normally be 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 be taken to be equal to 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 if purchased on the open market or would have realized if sold on the open market.

#### *Goodwill*

Where upon purchasing a business concern, 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 re-sold at a later stage to another person and the sale price includes trade goodwill the value of which is subject to tax on the seller the original cost of the trade goodwill to the seller is deducted from the new value of the goodwill sold and the balance if any is taxable on the seller of the business.

#### *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.

#### *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 (VAT)*

Cyprus's VAT legislation is fully harmonized with the European Union's sixth Directive as of 1 February 2002.

VAT is levied at the rate of 15 percent on a large number of goods and services, although goods exported from Cyprus are not charged VAT. 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. A sale of assets is, therefore, not in itself a transfer of a business as a going concern. If land and buildings are being sold, professional advice should be sought.

#### *Table B of the Cyprus VAT legislation*

The sale of shares is an exempt transaction specifically listed in Schedule Three; Table B of the Cyprus VAT legislation.

#### *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 EUR 85,430 of the value, 5 percent on the next EUR 85,430 of the values, 5 percent on the next EUR 85,430 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. The purchaser will, therefore, normally require 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 brought-forward loss cannot be set off against the profits of other companies through group relief, but can be set off against the company's own future profits.

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 three years before to three years after the date of acquisition. If the purchaser intends to change substantially the nature of the business of the target company it may be advisable to wait until at least three years have elapsed from the date of acquisition.

### *Transfer Taxes*

No stamp duty is payable on the consideration given for shares in a Cyprus company.

## **Choice of Acquisition Vehicle**

There are several potential acquisition vehicles available to a foreign purchaser and tax considerations will often influence the choice. There is a capital duty 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 will cause no tax problems in Cyprus, because it 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 10 percent. If the Cyprus operation is expected to make losses initially, a branch may be advantageous since, subject to the tax treatment applicable in the head office's country, there could be a timing benefit arising out of 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 will need to decide whether to fund the vehicle with a debt or equity, or even 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 income shall be deducted, including:

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

Note that under Cyprus Tax Law, it is not permitted to deduct any interest expenses in relation to the acquisition of a private motor vehicle (saloon car) or the acquisition of a non-business asset. However, after the lapse of seven 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.

## **Other Considerations**

### ***Company Law and Accounting***

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

Cyprus case law has been developed significantly since 1960, but, in the absence of Cypriot case law on particular legal issue matters, the court will look to U.K. case law which, although it may not be binding, is persuasive authority.

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

A private limited liability company by shares (CyCo) has a minimum authorized capital of EUR 8,543 and may have, as issued share capital, as little as one share.

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

The Companies Law allows mergers and reorganizations and cross-border mergers of limited liability companies. Tax laws incorporate provisions for tax-free corporate reorganizations in line with the EU Mergers Directive. The various forms of permissible reorganizations are as follows.

### ***Mergers***

- 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 issue to their shareholders, of shares 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 issue to their shareholders, of shares 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; and
- 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 issue to its shareholders, of shares 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.

#### *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 shall be deemed to be members of a Group if:

- One is 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 will only be allowed in cases where the surrendering company and the claimant company are both members of the same group for the whole year of assessment.

Losses within the group companies can offset, for purposes of corporation tax, the total chargeable corporate income in the corresponding year of assessment only. In computing the loss which 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 inter-company 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 at a rate of 8 percent on the balance, if an arm's-length interest rate is not charged.

#### **Foreign Investments of a Local Target Company**

The Cyprus controlled foreign companies (CFC) legislation is designed to encourage Cyprus companies, or a company which is not a resident of Cyprus but has a permanent establishment in Cyprus, which directly hold at least one percent of the share capital of the overseas dividend-paying company is exempted from tax. 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.
- It is possible to acquire only part of a business.
- Greater flexibility in funding options.

### ***Disadvantages of Asset Purchases***

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- Additional legal formalities apply in areas of notification of suppliers, change of name, etc.
- Where only assets are purchased, the initial price will be 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***

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

### ***Disadvantages of Share Purchases***

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- Possible restrictions on interest deductibility.
- Buyer inherits all undisclosed liabilities of the target company.
- Higher tax liability in the case of future disposal of assets due to lower cost base.

## Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends <sup>1</sup> (%)	Interest <sup>2</sup> (%)	Royalties (%)
Armenia <sup>2</sup>	0	0	0
Austria	10	0	0
Azerbaijan <sup>2</sup>	0	0	0
Belarus	5/10/15	5	5
Belgium	10/15	10	0
Bulgaria	5/10	7	10
Canada	15	15	0/10 <sup>3</sup>
China (People's Rep)	10	10	10
Czech Republic	10	10	0/5 <sup>4</sup>
Denmark	10/15	0/10	0
Egypt	15	15	10
France	10/15	0/10	0/5 <sup>5</sup>
Germany	10/15	10	0/5 <sup>5</sup>
Greece	25	10	0/5 <sup>5</sup>
Hungary	0	10	0
India	10/15	10	15
Ireland	0	0	0/5 <sup>5</sup>
Italy	0	10	0
Kuwait	10	10	0/5 <sup>4</sup>
Kyrgyzstan <sup>2</sup>	0	0	0
Lebanon	5	5	0
Malta	15	10	10
Mauritius	0	0	0
Moldova	5/10	5	5
Montenegro <sup>6</sup>	10	10	10
Norway	0	0	0
Poland	10	10	5
Romania	10	10	0/5 <sup>4</sup>
Russia	5/10	0	0
San Marino	0	0	0
Serbia <sup>6</sup>	10	10	10
Seychelles	0	0	5
Singapore	0	7/10	10
Slovak Republic	10	10	0/5 <sup>4</sup>
Slovenia	10	10	10
South Africa	0	0	0
Sweden	5/15	10	0
Syria	0/15	10	10/15 <sup>4</sup>
Tajikistan	0	0	0
Thailand	10	10/15	5/10/15 <sup>7</sup>
Ukraine <sup>2</sup>	0	0	0
United Kingdom	0	10	0/5 <sup>5</sup>
United States	0	0/10	0
Uzbekistan <sup>2</sup>	0	0	0

### Notes

1. The different rates in this column are not explained, because under Cypriot law no tax is withheld on dividends and interest even where a treaty allows such a tax.
2. The treaty concluded between Cyprus and the former USSR.
3. The lower rate applies to copyrights on literary, dramatic, musical, and artistic works, excluding films.
4. The lower rate applies to copyrights on literary, artistic, and scientific works, including film and television royalties.
5. The rate is 5 percent on films, etc.
6. The treaty concluded between Cyprus and the former Yugoslavia.
7. 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, and secret formulae or processes.

**KPMG in Cyprus**

Angelos M. Gregoriades  
KPMG  
12 Esperidon Street  
5th Floor  
Nicosia  
1087  
Cyprus

Tel. +357 22209000  
Fax +357 22513290  
e-Mail: [agregoriades@kpmg.com](mailto:agregoriades@kpmg.com)

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