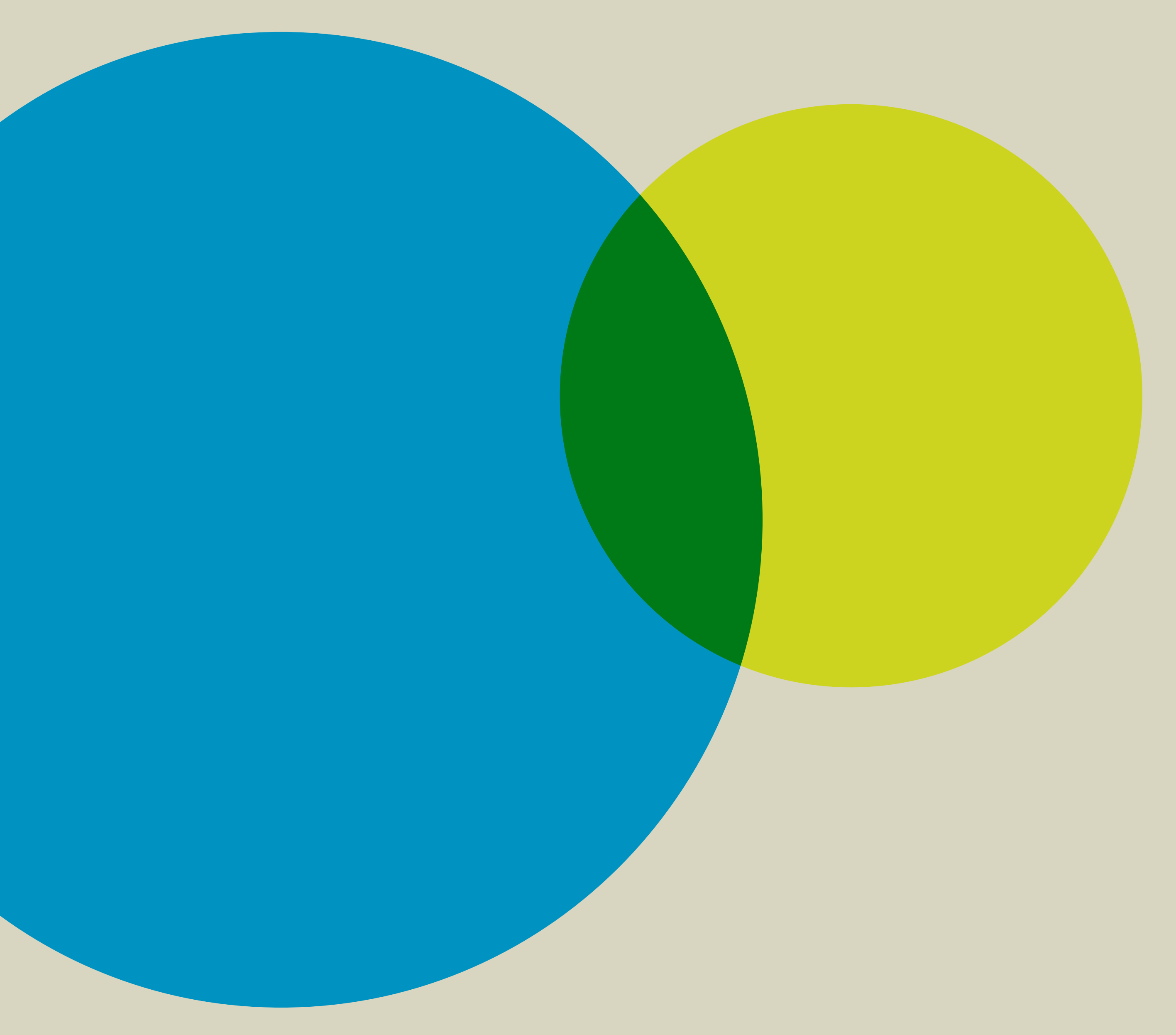
TAXAND
GLOBAL GUIDE TO M&A TAX
2018 EDITION
Your global tax partner



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# FOREWORD

**The M&A global market remained vibrant in 2017 with transactional volume coming in just under the 2016 level - 2017 was the fifth most active year in terms of global deal volume.[1] Global interest rates remain at historical lows, notwithstanding the slight increase in US rates. Roughly 15,000 deals transpired in the US, the most in a year since the beginning of the new millennium, with cross-border deals accounting for 30% of total deal volume (down slightly from 36% in 2016). In its May 2018 global outlook, the Organisation for Economic Cooperation and Development ("OECD") forecasted G20 growth rates of 4% and 4.1%, respectively, for 2018 and 2019 and forecasted non-G20 country growth slightly under 4% — encouraging forecasts all around.**

The unprecedented M&A cycle in which we find ourselves shows no signs of slowing halfway through 2018, either. According to Thomson Reuters, the number of deals exceeding USD5 billion in value in 2018 will double from 2017. Relative to 2017, overall M&A deal volume may have declined so far this year, but deal values have risen.

Although global economic strength clearly is providing fuel to this hot deal market, the following key factors are also fanning these flames, encouraging active market participants to continue engaging in M&A and those sitting on the sidelines to abandon their wait-and-see approaches:

**United States Tax Reform:** The largest US tax overhaul in more than 30 years provides a reduced top US corporate income tax rate, dropping from 35% to 21%. In addition, the new law taxes, albeit at a reduced rate, overseas earnings that were formerly taxed only upon repatriation, potentially making it less costly to repatriate offshore cash. Moody's estimated that at the end of 2017, US companies were holding roughly USD1.4 trillion in offshore cash; if repatriated, these large cash reserves will likely boost corporate involvement in M&A and potentially whip up the already frothy valuations the market exhibits.

**Private Equity Dry Powder:** High levels of dry powder available to financial buyers will also continue to contribute to the deluge of M&A activity. Data from Preqin suggest that PE funds held roughly USD1.1 trillion in cash at the 2018 mid-year mark. With such a cash hoard, funds should be well-positioned for the foreseeable future in M&A, whether competing with corporate buyers or making opportunistic investments in the event that a trade war or other market turbulence materializes.

**Brexit and European Elections:** Notwithstanding continued media noise around the UK vote to exit the European Union ("EU") and the need for the various governments to agree on the details of their prospective trade relationships, the powers that be appear to have constructed at least an outline of the path forward and largely alleviated the main concerns. The dissipation of such fears and the anticipation of a strong UK economy, should boost the European markets in the near- to mid-term. Further, recent election wins in key European countries by political parties espousing conventional views should encourage and provide confidence to the markets as the European economic recovery continues.

**Base Erosion Profit Shifting Initiative ("BEPS"):** The OECD has provided additional clarity into its BEPS project and its prospective administration. This has allowed multinationals to focus on compliance and to make relevant changes to their systems and processes. As companies' grasp on BEPS compliance firms, uneasiness in the market regarding international tax reform should continue to subside and provide more certainty with respect to sound tax planning.

**Shareholder Activism:** Over the last several years, shareholder activists have forced spin-offs or other disentanglements of non-core assets, permitting companies to focus on their strengths and to create more nimble and flexible models to gain competitive advantages. Fortuitously, US tax reform has made taxable dispositions of assets– as opposed to tax

[1] Cristerna, H. (2018), '2018 Global M&A Outlook: Navigating consolidation and disruption', JP Morgan, January 2018. Available at https://www.jpmorgan.com/jpmpdf/1320744801603.pdf (Downloaded: 20 August 2018)

free spin-offs — less burdensome and therefore more attractive in many cases for US multinationals than they have been historically. Shareholder activism should continue to drive M&A opportunities.

In the final analysis, the strong global economy and the factors mentioned above should continue to fuel global M&A activity in the short term. Cross-border M&A should continue to expand at a faster pace than purely domestic M&A as developing countries participate to a greater extent than ever in global markets. All indicators point toward a strong 2018 in M&A activity, with the transactional bears being held at bay for at least another year.

This edition of the Taxand Global Guide to M&A Tax has been designed as a desktop reference book covering 33 countries and to provide at-a-glance insight into the tax treatment of global mergers and acquisitions. It is intended to provide a basic introduction to M&A tax planning in each of the diverse fiscal environments in its scope and to facilitate understanding and conversation between global M&A tax team members; it should be viewed as a tool to help multinational advisors find common ground and mutual understanding, rather than as an encyclopedia. Global Taxand teams in each of the covered jurisdictions made essential and invaluable contributions to this book, and we thank them for their participation and support in this project. We are delighted to offer this guide as an example of the benefits that cross-border collaboration can produce.

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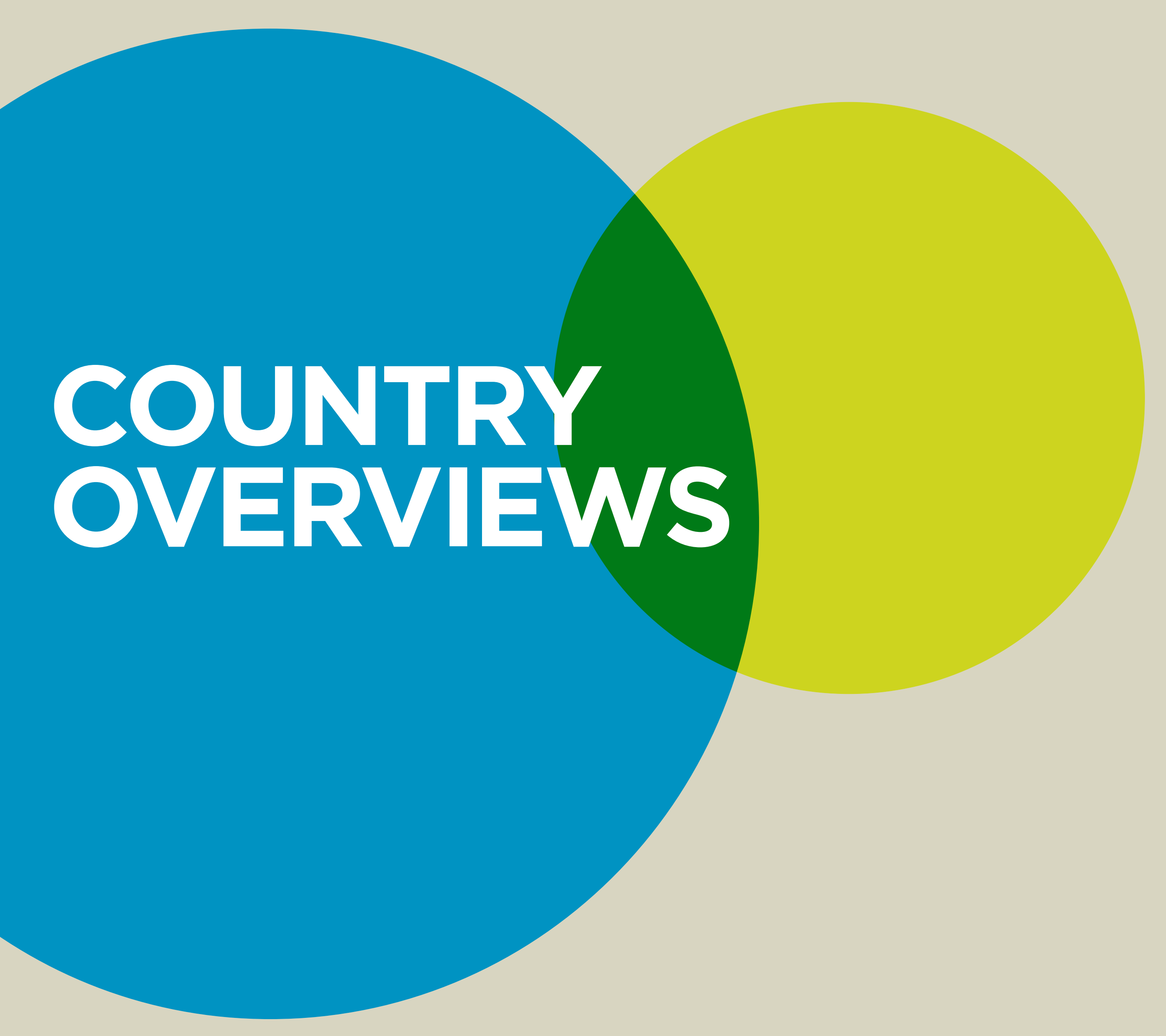

# COUNTRY OVERVIEWS

# ARGENTINA

# ARGENTINA

## INTERNATIONAL DEVELOPMENTS

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

On 29 December 2017, it was published on the Official Gazette the Act No 27.430 (the "Tax Reform Act"), which introduces several modifications to the former tax regime. The Tax Reform Act is generally effective 1 January 2018. Specifically, the tax reform measures include changes concerning the corporate income tax rates, dividend withholding tax, taxation of certain financial investments, indirect capital gains taxation, interest limitation rules, the definition of a permanent establishment, transfer pricing, fiscal transparency rules and revaluation of assets, among others. In addition, the Tax Reform Act introduces amendments to value added tax law, tax procedural law, criminal tax law, social security contributions rules, tax on fuels and tax on the transfer of real estate, among other aspects.

It is important to point out that the regulatory decree of said Act is still pending.

Also, act No. 26.190, as amended by act No. 27.191, sets forth the Renewable Energies Promotional Regime which tends to incentivize the use of renewable energy sources for the production of electricity, and which foresees significant tax benefits such as anticipated VAT refund, accelerated depreciation and a tax certificate, among others.

Furthermore, Act No. 27,264 and Act No. 27,349 established a promotional regime for small, medium and micro companies ("PYMES" in Spanish) and for entrepreneurial activity which includes a number of tax benefits.

### 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?

On June 7, 2017, Argentina signed the "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" to update most of its treaties to avoid double taxation in line with BEPS.

Also, Argentina has signed the OECD Declaration on BEPS, the OECD Multilateral Convention on Mutual Administrative Matters, OECD Declaration on Automatic Exchange of Information and the Multilateral Competent Authority Agreement.

Treaties to avoid double taxation with Chile, México and United Arab Emirates were signed in 2015 and 2016 (the latter still undergoing internal ratification procedures prior to entering into force). Argentine tax authorities in the most recently signed treaties have adopted several BEPS directives (including LOB provisions, PPT clauses, and additional considerations regarding "permanent establishment" assessment). Additionally, an amendment protocol to the treaty currently in force with Brazil was signed in 2017, which foresees many BEPS directives. Other treaties include anti-abuse clauses, such as the treaties with Spain and Switzerland.

BEPS measures are not new in Argentina. During the last years the Argentine tax authorities challenged tax-motivated transactions and structures on the basis of 'substance over form' principles as construed in case law. In addition an Argentine government commission was created to review the country's tax treaty network to determine whether there was potential for abuse; and new tax information reporting requirements were created, among other measures.

On 29 December 2017, the Tax Reform Act was approved and many of the changes introduced are in line with OECD and BEPS standards (mainly regarding interest limitation rules, permanent establishment assessment rules, "sixth method" regarding transfer pricing rules, Country by Country reporting, Mutual Proceeding Arrangements, Advance Pricing Proceedings, among other subjects).

## GENERAL

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

**From a buyer's perspective**

**A) Share deals**

The procedure is simple.

There is no substantial tax cost.

The tax losses of the Argentinean company are transferred to the buyer. Also, the tax credits arising from taxes other than income tax remain in the company and, consequently, are 'transferred' to the buyer.

The Argentine company's liabilities remain in the company and, consequently, are 'acquired' by the buyer. If the Argentine company's shares are purchased by an Argentine company, the acquisition cost of the shares cannot be depreciated for income tax purposes. Regarding acquisitions or investments, the Tax Reform Act provides the possibility to apply certain actualization [ed.: indexing] methods established in the income tax law under certain conditions. In certain cases, the shareholder could be subject to said methods.

The purchaser keeps the depreciation terms of the seller's assets.

**B) Asset deals**

The procedure is complex.

The tax losses of the seller's company are not transferred to the buyer except if the transfer is of a going concern under a tax-free reorganization.

The business's 'non-assessed tax and social security liabilities' are not transferred from the seller to the buyer if the appropriate notification to the AFIP is made prior to the transfer of the assets and the AFIP does not take any action within a prescribed period of time.

The seller's unpaid 'assessed tax and social security liabilities' are transferred to the buyer.

The buyer depreciates the acquisition cost of the portion of the purchase price corresponding to the fixed assets. However, the portion of the purchase price that exceeds the purchase price of the fixed assets and inventories is considered goodwill of the buyer and is not subject to tax depreciation in Argentina.

**From a seller's perspective**

**A) Share deals**

The sale of S.A., S.A.U, and S.A.S shares or SRL quotas by Argentine companies, Argentine individuals and/or foreign individuals or companies is subject to income tax (see section 20).

Although the tax debts are transferred to the buyer, the directors of the Argentinean company who were in charge during the period of such tax debt would remain jointly and severally liable if the Argentinean company does not pay the tax debt claimed by the AFIP.

The procedure is simple.

**B) Asset deals**

The sale of assets is subject to taxation. The tax impact for the seller is made up of income tax, VAT on the transfer of certain assets (VAT is usually not an economic cost for Argentinean taxpayers), tax on debits and credits in Argentinean bank accounts, turnover tax (generally fixed assets are exempt from this tax) and stamp tax on certain agreements.

The seller's tax losses are not transferred to the buyer, except if the transfer is of a going concern under a tax-free reorganization.

The seller always remains liable for tax debts related to the assets.

The procedure is complex.

## 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?

In principle, there are no special provisions in Argentina's income tax law that provide a step-up in the value of the underlying assets in share deals.

However, each case should be analyzed separately. For example, a step-up could be applicable in a purchase of assets.

It is important to note that the Tax Reform Act creates a Revaluation of Assets Regime for Taxation and Accounting Purposes. This regime enables individuals, undivided estates and companies, all of which must be residents in Argentina, to opt for the reassessment of the assets, which produce argentine source income, in order to determine the income tax.

For this purpose, said regime provides a method for the revaluation of the assets, by applying a "revaluation factor" to the original value of the assets. In certain cases, the taxpayer may choose the application of a revaluation factor or a revaluation performed by an appraiser expert. The adherents to this regime would be liable for the payment of a special tax on the difference between the asset's residual value for tax purposes and the tax value determined, at the time of exercise of the option. The applicable rates vary from 5% to 15%, depending on the assets involved.

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

As a general rule, Argentina's income tax law does not allow the deduction of intangibles such as goodwill, trademarks and similar assets.

However, depreciation of intangible assets with limited economic useful life — such as concessions, patents and licenses — can be deducted for income tax purposes.

### 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?

**Interest limitation rules**

The Tax Reform Act provides a new limitation on the deduction of interest expenses arising from financial debts obtained with related parties (either local or foreign companies) and replaces the previously applied rule based on debt-to-equity ratio exceeding 2:1. This limit will be the greater of 30% of earnings before interest, depreciation, and amortization, or an amount to be fixed by the executive authority.

If the amount of interest expense is less than the limitation, the unused limitation can be carried forward for three tax years.

Likewise, if the interest amount exceeds the limit established, the difference can be carried forward for five tax years.

Notwithstanding the above, such limitation would not apply on the following:

a) Subjective exceptions:

- Interest paid by Argentine financial institutions, financial trusts, leasing companies, and/or any other entity to be determined by the Argentine Government (considering the nature of its main activity).

b) Objective exceptions:

- Commercial debts
- The amount of interest revenues obtained by the Argentine entity
- Any amount of interest, if it is demonstrated that the beneficiary paid income tax in Argentina on those payments.

These rules are effective for tax years beginning on or after 1 January 2018. Please note that the regulatory decree of the Tax Reform Act is still pending.

**Transfer pricing rules**

Argentina's income tax law also provides transfer pricing provisions relating to deductions for payments by Argentinean taxpayers to non-Argentinean related parties.

Deductions can only be made to the extent that the terms and conditions agreed upon with the related party are in accordance with the 'arm's length principle' in Section 14 of the income tax law. This provision basically holds that any transaction between related parties must be regarded as entered into between independent parties. This is the case insofar as the consideration and conditions are consistent with normal market practices between independent parties.

As evidence of compliance with the arm's length standard, local taxpayers must prepare and submit a transfer pricing study (that includes comparability and economic analyses). Such transfer pricing studies must include the functions, activities and risks borne by each party in the transaction and an explanation of the transfer pricing method used. Failure to submit the transfer pricing study and information returns is subject to severe penalties.

Local taxpayers carrying out transactions with non-resident related parties are also required to maintain additional documentation, which must demonstrate the correct determination of the prices or profit margins that are declared in the informative returns and the acceptability of the comparability criteria used in determining such prices.

As a result, these transactions are subject to the Argentinean transfer pricing rules. Please note that, in accordance with Section 15 of the income tax law, transactions made by Argentinean entities, among others, with companies domiciled, registered or located in low-tax or null-tax jurisdictions listed in its regulatory decree (whether or not related to the Argentine entities) will not be considered compliant with the arm's length principle and, therefore, will be subject to the transfer pricing rules.

In view of the Argentinean transfer pricing provisions; the interest payments in the cases mentioned above should follow the arm's length principle in order to allow the Argentinean party its full deduction for income tax purposes.

**Test debt/equity**

Over the past years, the AFIP has been focusing on the deduction of interest associated with loans granted by foreign lenders under certain conditions. Based on a series of circumstances such as, among others, the lack of proper documentation, the absence of usual indemnity and guarantee agreements and interest rates that do not correspond with market standards, the AFIP has been presuming that the aim of certain loans under scrutiny was to erode the tax basis of the local borrower. This has resulted in denied deduction of interest payments and exchange differences.

**Evidence to prove the existence of loan agreements**

If the existence of the loan were not proved, the registered liabilities could be considered an 'unjustified wealth increase' (subject to taxes accordingly) and the deduction of interest and exchange differences for income tax purposes could be challenged. In order to avoid any challenges from the AFIP, certain formalities and facts are relevant or advisable to prove the existence of loan agreements.

**Limitations on deduction of loan interest related to the acquisition of shares**

AFIP does not allow Argentinean companies to deduct interest payments on loans related to the acquisition of shares of an Argentinean company.

This is based on the fact that dividends or distribution of profits received by Argentinean entities from other Argentinean entities were not subject to income tax and, therefore, such interest was not related to the company's taxable income.

Therefore, AFIP argues that such deductions do not comply with the general requirements for income tax deductions.

Nevertheless, since there are conflicting judicial precedents, the subject matter is open to discussion. Please note that this issue may change as a consequence of the taxation of dividends, which was introduced by the Tax Reform Act.

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

Common strategies to push down debt on acquisitions include a leveraged buyout of the target company. Under this scenario the AFIP does not allow Argentinean entities to deduct interest payments if the proceeds of the loan are applied to the acquisition of an Argentinean company's shares. This is based on the fact that dividends or distribution of profits received by Argentinean entities from other Argentinean entities were not subject to income tax and, therefore, such interest was not related to the company's taxable income.

In this regard, the AFIP has issued administrative precedents in the last years that have not allowed such interest deductions. There is also a precedent from Argentina's Federal Tax Court holding the AFIP's position, which was subsequently confirmed by the Federal Court of Appeals (and the Federal Supreme Court for formal reasons).

However, there are also recent judicial precedents in the opposite direction. The jurisprudence is divided. The Federal Supreme Court has yet to express a direct opinion on the subject matter.

It could be argued that such interest payments should be deductible because:

1. Dividends are taxed both at the distributing company's level and at the time of distribution, following the 'integration system' adopted by Argentina.
2. Future capital gain arising from the sale of Argentinean shares by Argentinean companies, Argentine individuals and foreign companies or individuals is subject to income tax. Please note that the approach to this matter may change as a consequence of the taxation of dividends, which was introduced by the Tax Reform Act.

If the Argentinean entity finances the acquisition by issuing private bonds with public offering, this provides a strong case to sustain the interest deduction. Private bond law states that the interest payments are fully deductible for income tax purposes if certain requirements are met. AFIP does not allow a deduction for such interest either. However, there is a precedent from Argentina's Federal Tax Court allowing the deduction of interest in this case, which has also been confirmed by the Federal Court of Appeals (and the Federal Supreme Court for formal reasons). The second part of the leveraged buyout is the merger between the buyer entity and target entity. In order to perform a merger under the tax-free reorganization regime certain requirements must be met. Two of the main requirements hold that both entities should have maintained the same or related activities for at least 12 months before the date of reorganization, and that the continuing entity must maintain the same or

related activities as the previous entities for at least 2 years from the date of the reorganization. Due to certain precedents of the Federal Supreme Court, the AFIP has recently allowed, in rulings, the tax-free merger conducted between a holding entity and an operative entity of the same economic group even when the aforementioned requirements were not satisfied. Also, if certain conditions are met, the tax-free reorganization could be possible in this alternative scenario.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no tax incentives for equity financing in Argentina.

Please note that Act No. 27,349 provides tax benefits for Venture Capital Institutions. In this regard, local investors will be able to deduct a percentage of the total investments they perform in Venture Capital Institutions or Ventures. Regular investors will be able to deduct up to 75% of the total investment and, investors who invest in less developed areas or with lower access to financing, will be able to deduct up to 85%. They will be able to deduct a maximum of 10% of their net income.

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

In share deals, the target company's tax losses are transferred to the buyer.

Also, under the scenario of a tax-free reorganization, tax losses can be transferred from one company to another, provided that certain requirements are met (see section 15). Argentina's income tax law provides for three types of tax-free reorganization: mergers, spin-offs and transfers within the same economic group.

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

Provide all material in connection with intercompany transactions corresponding to the last 6 fiscal periods. Provide documentation regarding transfer pricing filings with the Argentine tax authority (AFIP General Resolution 1122).

List of judicial or administrative claims made by the Federal, Provincial or Municipal Tax Authorities against the Argentine company.

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

**Federal Taxes**

Tax on debits and credits is levied on debits and credits on Argentine bank accounts and other transactions that are used as a substitute for checking bank accounts. The general rate is 0.6%, however there are increased rates of 1.2% and reduced rates of 0.075%. Thus, if Argentine bank accounts are used for the payment for shares, this transaction would be subject to tax at a rate of 0.6% applicable on each credit or debit on Argentine bank accounts. Part of this could be used as a credit against income tax and/or minimum presumed income tax (MPIT), and the remaining amount is deductible for income tax purposes.

No other indirect tax (such as VAT) applies on transfer of shares.

**Provincial taxes**

**A. Gross turnover tax.**

Gross turnover tax could be applicable to Argentine residents on the transfer of shares to the extent such activity is conducted on a regular basis within an Argentine province or within the City of Buenos Aires. However, please note that in certain jurisdictions (e.g. City of Buenos Aires) exemptions may apply.

**B. Stamp Tax**

The stamp tax could be applicable in the jurisdiction in which the transaction documents are executed but, in addition, it may also apply in the jurisdiction in which the transaction has effects. Please note that documents executed abroad may also be subject to stamp tax to the extent their effects take place in an Argentine province or in the City of Buenos Aires.

However, exemptions could apply in certain jurisdictions for the transfer of shares of Argentine companies. Also, there are some alternatives, depending on the transaction, to enter into agreements that are not subject to the stamp tax.

**C. Free transmission of goods tax**

The province of Buenos Aires establishes a tax on free transmission of assets, including inheritance, legacies, donations, etc. Hence, free transmission of shares could be subject to this tax.

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

According to AFIP's position, costs incurred on the acquisition of an Argentinean company's shares (e.g. interest on loans, legal fees, advisory fees, etc.) are not deductible for income tax purposes (see section 7) on the grounds that such expenses are not necessary for the obtainment, maintenance and conservation of taxable income.

However as we mentioned in section 7 the deductibility of such expenses may be argued.

Also, although it is not free from doubt, it could be argued that legal or advisory fees should be included as part of the acquisition cost of the shares. Under said scenario, such expenses would not be deductible for income tax purposes. Nevertheless in case of a future sale of the shares the sale price would be compared to a higher acquisition cost.

Please note that the criteria on this matter may change as a consequence of the taxation of dividends, which was introduced by the Tax Reform Act.

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

In general, Argentine VAT is levied on three different classes of transactions, namely: the sale of tangible personal property within Argentina; the definitive import of tangible personal property and services into Argentina; and the provision of services within Argentina.

In this regard, the provision of advisory or legal services for the acquisition of an Argentine company would be subject to VAT as they will be "economically used" in Argentina. Hence, VAT paid for the aforementioned transactions will constitute a VAT credit to be compensated only against VAT debits (i.e. against its output VAT).

If VAT credits for the rendering of the services cannot be compensated they should be included as part of the acquisition cost of the shares.

There is a regime that establishes the early reimbursement of VAT credits in case of the acquisition of capital goods and infrastructure works.

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

There are no particular issues in the acquisition of Argentine shares by foreign companies. However please note the following:

- The sale of shares of an Argentine company is subject to income tax in Argentina
- Due to inflation and devaluation scenario in Argentina any capital gain from the sale of shares of an Argentine company could be high since the acquisition cost of the shares is historical and should be determined in local currency at the moment of the purchase.
- Indirect sale of Argentine shares is subject to income tax at a 13.5% rate over the gross income and at a 15% rate over the actual net income. The tax has to be paid when:
  - At least 30% of the market value of shares, interests, units, securities or rights held by such seller in the entity located abroad, upon the sale or during 12 months prior to the sale, is due to the value of the Argentine assets directly or indirectly owned by the seller. Such assets include:
    - Shares, rights, units or other interests in ownership, control or earnings of a company, fund, trust or any other entity established in Argentina.
    - Permanent establishments in Argentina that are owned by one person or entity not residing in the country.
    - Other assets of any nature located in Argentina or any interests therein.

  For these purposes, the assets in the country are to be stated at the current market value.

  - Shares, interests, units, securities or rights sold which, at the moment of the sale or during 12 months prior to the sale, account for at least 10% of the equity of the foreign company that directly or indirectly owns the above mentioned assets.
- Argentine entities should pay Personal Asset Tax at a rate of 0.25% on the net worth on behalf of foreign shareholders.
- Transactions between related parties must comply with transfer pricing regulations.
- If Argentinean bank accounts are used, tax on debits and credits would apply.
- If the sale is between two non-Argentine residents, the tax has to be paid by the foreign seller's legal representative domiciled in Argentina. If the seller does not have a legal representative domiciled in Argentina, the tax shall be paid by the foreign seller through international wire transfer.

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

The group can be reorganized after the acquisition in a tax neutral environment if a tax-free reorganization is performed.

Argentina's income tax law provides for three different types of tax-free reorganization procedures: merger, spin-off or transfer within the same economic group. The law sets forth special provisions required to achieve a tax-free reorganization in which the assets and tax status of a company may be transferred with attractive tax benefits. If the law's requirements and regulatory provisions are met, the tax-free reorganization is subject neither to federal taxes (i.e. income tax and VAT) nor, in certain cases, to provincial taxes (i.e. turnover tax and stamp tax).

Failure to comply with these requirements causes the tax-free reorganization regime to be inapplicable and, therefore, the transaction becomes subject to applicable federal and provincial taxes.

For a merger or spin-off to qualify as a tax-free reorganization under Argentina's income tax law, and for the tax status to transfer to the continuing or surviving company, the following general requirements must be met:

**1)** The owners of the previous company or companies must have held at least 80% of their capital in the two years prior to the reorganization. This requirement is mandatory only to transfer income tax losses and promotional regime benefits. This requirement does not apply to companies whose shares are listed.

**2)** Capital must be maintained at the moment of and after the reorganization

**3)** The companies must have been conducting the same or related business prior to the date of reorganization

**4)** The same or related activities of the previous company must be continued for at least two years from the date of the reorganization

**5)** A tax report must be filed before the AFIP

Compliance with all requirements established under a merger or spin-off scenario is required when qualifying a transfer within the same economic group as a tax-free reorganization. Exceptions are made in fulfilling related activities prior to the tax-free reorganization, the requirement of conducting business prior to the tax-free reorganization and certain capital requirement differences.

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

The sale of real estate is subject to income tax on net income. The final income tax of Argentina legal entities is calculated at the end of the fiscal year by applying the 30% corporate income tax rate for fiscal years initiated after January 1, 2018 and up to December 31, 2019; and at the rate of 25% for tax periods initiated after January 1, 2020 and onwards. The real estate transaction affects the result of the fiscal year as per the difference between the sale price and the acquisition cost of the land plus the depreciated construction and improvements cost. The depreciation of the premises and improvements takes place at a rate of 2% per year; for real estate, the depreciation is 2% per year over 50 years.

The collapse of the Argentine financial system resulted in the Argentine Peso's devaluation from its 10-year-long exchange rate of US$ 1 = AR$1. In addition, after 2002 Argentina has fallen into an inflationary scenario and inflation adjustments have not been allowed for tax purposes. Therefore, until fiscal years initiated after January 1, 2018, any capital gain from the sale of real estate could be high since the real estate cost is historical.

Please note that the Tax Reform Act creates a Revaluation of Assets Regime for Taxation and Accounting Purposes (see section 4) and foresees a regime of inflation indexing of assets.

Rollover transactions are applicable in Argentina: whenever a depreciable asset is sold and replaced income derived from the sale transaction may be assigned to the new asset's cost, resulting therefore in a deferral in the recognition of built-in gains. General depreciation rules provided in the income tax law are then applied on the cost of the new asset reduced by the assigned income amount. This option is available to the extent that sale and replacement are performed within a one-year term.

In general, real estate transfers are not subject to VAT. However, if the seller uses the premises as a fixed asset, the seller must pay VAT in some specific cases, if the property is sold within 10 years after the date the seller obtained permission to use the premises.

The holding of real estate is subject to minimum presumed income tax. Investments to construct new buildings or make improvements in real estate that are fixed assets are not subject to the minimum presumed income tax in the construction year as well as the following year.

The sale of real estate could be subject to turnover tax. Generally, the sale of fixed assets is exempt from turnover tax.

The sale of real estate is subject to the stamp tax in the city of Buenos Aires at a rate of 3.6%. If the real estate is in a jurisdiction other than Buenos Aires, the tax treatment may vary.

An alternative is to sell the Argentine entity's shares. In general terms, real estate investments in Argentina are usually structured under two possible scenarios:

**1)** Direct acquisition of the real property made by a local vehicle (e.g. an Argentine corporation or branch)

**2)** Acquisition of shares in an Argentine corporation ('sociedad anónima', "sociedad anónima unipersonal", and "sociedad por acciones simplificada", in Spanish) that owns the real property. The applicable tax treatment for each scenario would have certain advantages and disadvantages. The chosen alternative will depend on the purpose of the transaction.

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

Tax grouping is not allowed in Argentina.

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

There is not a special tax status for companies that hold intangible assets.

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

There are not adverse tax consequences. The transfer is subject to tax even if the seller is an individual.

# 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?

No participation exemption regime is available in Argentina. The results derived from the transfer of S.A, S.A.U and S.A.S shares, SRL quotas and other securities are subject to Argentine income tax, regardless of the type of person receiving the income.

**A.** Capital gains derived by Argentine corporate entities (in general, entities organized or incorporated under Argentine law, certain traders and intermediaries, local branches of non-Argentine entities, sole proprietorships and individuals carrying on certain commercial activities in Argentina) from the sale, exchange or other disposition of shares are subject to income tax at the rate of 30% on net income for fiscal years initiated after January 1, 2018 and up to 31 December 2019 and at the rate of 25% for tax periods initiated after January 1, 2020 and onwards. Any loss derived from the transfer of shares may only be offset against profits of the same source from the same type of transactions. If such offset cannot be made in the same fiscal year in which the loss occurred or such loss cannot be offset in full, then such amount may be offset against income of the same source generated by the same type of transactions in the immediately subsequent 5 fiscal years.

**B.** Income obtained by Argentine resident individuals from the sale of shares is subject to income tax at a 15% rate on net income, unless such securities were traded in stock markets and/or have public offering authorization, in which case, under certain conditions, an exemption applies. Any loss derived from the transfer of shares may only be offset against profits of the same source from the same type of transactions. If such offset cannot be made in the same fiscal year in which the loss occurred or such loss cannot be offset in full, then such amount may be offset against income of the same source generated by the same type of transactions in the immediately subsequent 5 fiscal years.

**C.** Capital gains obtained by non-Argentine resident individuals or non-Argentine entities (the "Foreign Beneficiaries") from the sale, exchange or other disposition of shares are exempt from income tax if the shares are issued by an Argentine company and are authorized for public offering by the CNV. The exemption on the sale of Argentine shares would only apply to the extent that the Foreign Beneficiaries reside in or their funds come from jurisdictions considered as cooperative. The list of non-cooperative jurisdictions shall be published by the Executive Branch. Decree 279/2018 establishes that until the Executive Branch issues the non-cooperative jurisdictions list, taxpayers should consider the list of "cooperative jurisdictions" published by the Argentine tax authorities to determine whether a jurisdiction is deemed cooperative or not. The tax rate applicable to the sales of shares conducted by non-Argentine residents that reside in or whose funds come from non-cooperative jurisdictions is 35%.

If the exemption does not apply, the gain derived from the disposition of shares is subject to Argentine income tax at either (1) a 15% rate on the amount resulting from the deduction from the gross profit paid or credited, the expenses incurred in Argentina necessary for its obtainment, maintenance and conservation, as the deductions admitted by the income tax law or (2) at a 13.5% rate on the sales price. There is currently no guidance under Argentine law with respect to how this election is made. Please note that these rates could be reduced in certain scenarios due to the application of a Double Taxation Treaty. If the sale is between two non-Argentine residents, the tax has to be paid by the foreign seller's legal representative domiciled in Argentina. In case the seller does not have a legal representative domiciled in Argentina, the tax shall be paid by the foreign seller through international wire transfer.

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

In general, Argentina does not provide any fiscal advantage if the proceeds from a sale are reinvested. Argentina only provides fiscal advantages for reinvestments in depreciable assets (i.e. real estate or movable assets). In this particular case, if the depreciable asset is sold and replaced, the taxpayer can either (i) charge such income to the fiscal period or (ii) apply such gain to the cost of the new depreciable asset. Therefore, the depreciation rules provided in Argentina's income tax law would then be applied to the cost of the new asset reduced by the assigned income amount. The sale and replacement of depreciable assets must take place within a one-year term for the taxpayer to apply this regime.

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

No. However, if the shareholders of the companies are Argentine residents, there is a new CFC regulation by which many holding companies would be considered transparent for tax purposes. It has to be analyzed on a case by case basis. These substance requirements are not defined.

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

Please refer to our comments in section 15 above.

## MANAGEMENT INCENTIVES

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

There are no special incentives other than the contributions that the directors can make to mutual guarantee companies, pension plans or other special forms of insurance.

Furthermore, there is no special treatment for stock options, since they are subject to income tax as of the moment that the option is exercised, but not before.

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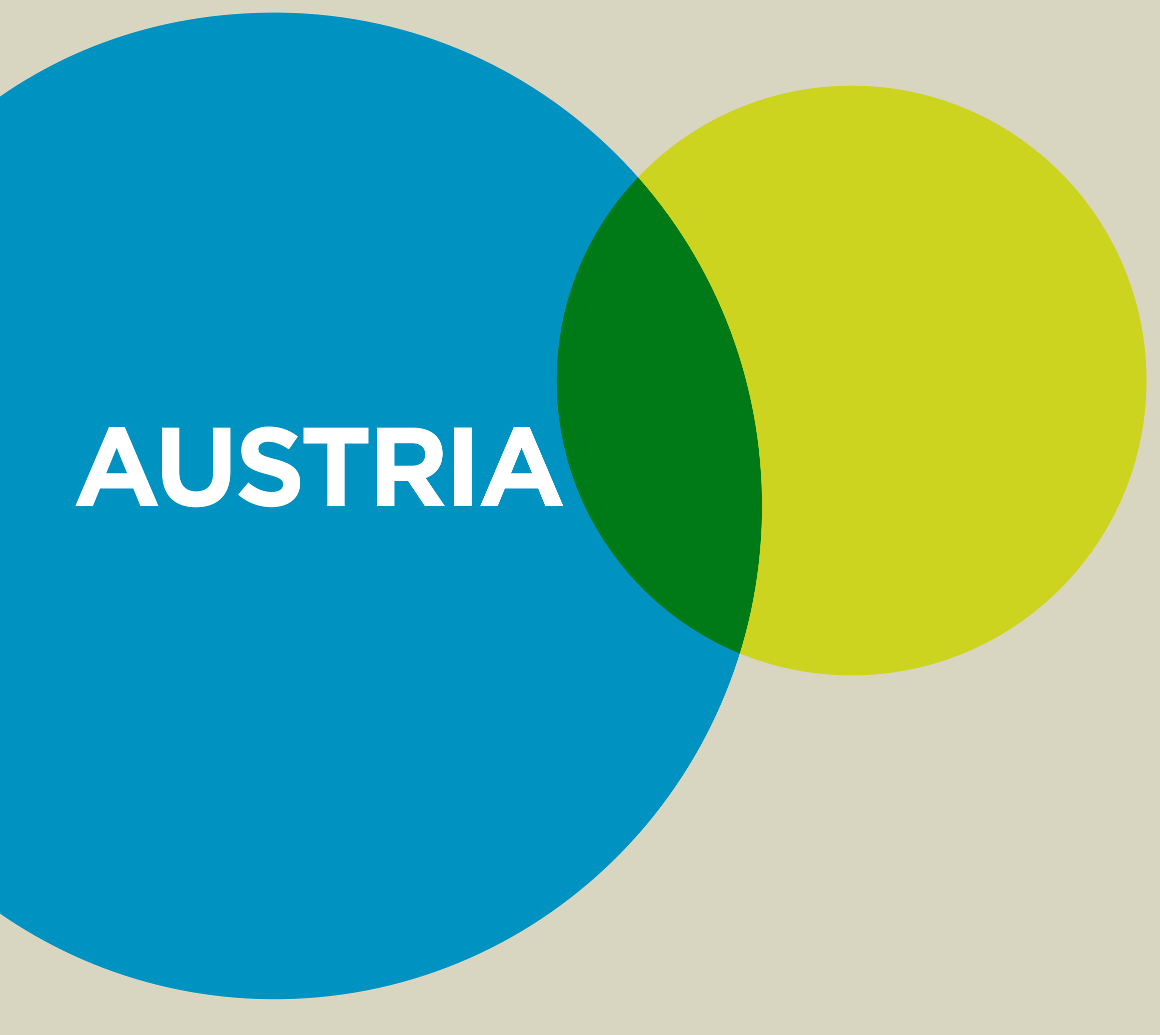

# AUSTRIA

# AUSTRIA

## INTERNATIONAL DEVELOPMENTS

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

The Austrian draft Tax Amendment Act 2018 (Jahressteuergesetz 2018) issued by the Ministry of Finance on 9 April 2018 provides e.g. for the following amendments:

- Implementation of a CFC-rule (based on EU-ATAD) with effect for financial years starting after 30 September 2018
- Expansion of Advance Ruling to the following topics: "International Tax", "Abuse" (with effect as of 1 January 2019) and VAT (with effect as of 1 January 2020)
- With effect from 1 January 2019, the time frame for the payment of instalments with regard to the Austrian exit tax (generally available for exits to other EU-member states) shall be reduced from seven to five years

### 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?

Austria has conducted the following measures with regard to the implementation of BEPS actions:

**Action 2 – hybrid mismatch:** Dividend income or other payments obtained by Austrian resident corporations from participations or other forms of investments in a foreign corporation or subsidiary are disqualified from Austrian CIT exemption insofar as these payments are tax-deductible at the level of the foreign corporation. This could be especially the case where investments in a foreign company are characterised from an Austrian perspective as equity and from the foreign tax law perspective as debt.

**Action 3 – Controlled Foreign Company Rules (CFC):** Austria currently has no CFC rules (a draft of new CFC legislation for fiscal years starting after 30 September 2018 was recently published), however the international participation exemption regime, applicable for qualified international participations (> 10% participation, holding period > 1 year), is replaced by a credit method regime, whereby underlying foreign corporation taxes are credited against Austrian corporation tax, if the foreign subsidiary generates mainly passive income (interest, royalties, rental and lease income, capital gains from the disposal of shareholdings) (passive business focus), and the effective tax rate of the foreign subsidiary is 15% or lower. Apart from that, a switch-over between regimes is also applicable for international portfolio participations (< 10%) if the foreign distributing company is subject to low taxation in its country of residence, irrespective of the type of income. A low tax is defined as an effective tax rate of not more than 15.

**Action 4 – Interest Deductions:** With effect from 1 March 2014 Austria implemented a targeted interest (and royalty) limitation rule (not limited to the acquisition of participations) which is applicable if the following conditions are fulfilled:

- The recipient is a corporation or a comparable foreign corporation
- The recipient is a direct or indirect member of the same group or controlled directly or indirectly by the same shareholder
- The interest (or royalty) payments are not subject to tax at the level of the receiving entity owing to a personal or objective tax exemption, or if the nominal or effective tax rate (tax refunds are taken into account) is less than 10 per cent

This rule must be applied to the beneficial owner of the interest; therefore, any interposed entities are disregarded and the tax regime of the beneficial owner needs to be checked. In case of transparent entities under Austrian tax law (e.g., partnerships, investment funds, etc.) the rule applies to the corporate entity (partner, investor) behind the transparent entity. As this targeted rule is considered by the Austrian ministry of finance as equally effective as the interest limitation rule as stipulated in Art 4 of the EU-Anti Tax Avoidance Directive, the obligation to implement the interest limitation rule by 1 January 2019 could be deferred (until 1 January 2014 at the latest), however, so far no consent of the EU commission on the equal effectiveness has been granted.

**Action 5 – Harmful tax practices; Action 6 - Treaty abuse:** Under the Austrian corporate tax law a substance over form approach is applied. Thus, entities are ignored for Austrian tax purposes (look through approach) where they do not meet certain substance requirements (i.e. office space rented or owned in own name, employment of people, management carried out at the seat of the company).

**Action 7 – Permanent Establishments:** In accordance with the MLI and the artificial avoidance of permanent establishment status, Austria applies Option A according to Art 13 (1) MLI. Preparatory or auxiliary activities are regarded as non-PE-establishing activities, irrespective of the provisions of a covered tax treaty and the definition of the term permanent establishment in those treaties. This implies that the listing of PE-excluding activities in the respective tax treaties have to be reviewed in the light of the actual characteristic as a preparatory or auxiliary character of the activity of the company's business model. Despite the listing of the PE-excluding activities, a "core business activity" will constitute a PE.

**Action 8 – 10 and 13 Transfer Pricing:** On 1 August 2016 the Austrian Transfer Pricing Documentation Law (TPDL) was officially published in Austria. Based on the TPDL, transfer pricing documentation must be prepared for fiscal years starting on or after 1 January 2016 Transfer Pricing documentation requirements for prior fiscal years as well as for local constituent entities not covered by the TPDL are based on the Austrian Federal Fiscal Code (FCC), taking into account the OECD Transfer Pricing Guidelines.

With the TPDL, the three-tiered standardised approach to transfer pricing documentation, as proposed by the OECD, including master file (MF), local file (LF) and country-by-country (CbC) reporting, became obligatory in Austria:

- MNE groups must prepare a CbC report containing information on the worldwide distribution of their revenue, taxes, etc., if the consolidated group turnover amounted to EUR 750 million or more in the previous fiscal year
- Austrian constituent entities of a multinational company must prepare a MF (report about the whole company's group and its worldwide economic activity and its transfer pricing policy) and LF (report about the business transactions in the Austrian company) if their turnover exceeded EUR 50 million in each of the two previous fiscal years

The Austrian tax law does not provide for specific rules on the determination of transfer prices. In general, transfer pricing issues are governed by the provisions concerning hidden profit distributions, hidden contributions and the cross-border transfer of assets. In practice, the tax authorities generally refer to the OECD Transfer Pricing Guidelines as the main basis when examining the accuracy of transfer prices. In October 2010 the Austrian Ministry of Finance published its own Transfer Pricing Guidelines which do not have a legally binding force but are of significant practical relevance.

Binding rulings are available in transfer pricing issues (costs amounting between EUR 1,500 and 20,000 depending on the turnover of the requesting taxpayer).

**Action 14 – Dispute Resolution:** The EU Arbitration Convention – to which Austria is a member - establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States. The Convention provides for the elimination of double taxation by an agreement between the contracting states including, if necessary, by reference to the opinion of an independent advisory body.

**Action 15 – Multilateral instrument:** Austria has signed the Multilateral Instrument (MLI – "Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting). From an Austrian constitution perspective, the MLI constitutes an intergovernmental contract, comparable to double tax treaties, which has to be transformed into domestic law. The MLI provisions regarding the alterations of the double tax treaties will enter into force as of 1 July 2018.

## GENERAL

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

In a share deal situation the shares of a company are acquired and the ownership is transferred by way of universal succession. The main characteristics of a share deal are summarised as follows:

- Primarily contractual liabilities. Under certain conditions a liability based on Art 1409 Austrian civil code (ABGB) is possible
- No step-up of asset book values
- No goodwill capitalisation and depreciation
- Tax loss carry forwards are maintained at the level of the target, if the provision regarding the purchase of corporate shells (*Mantelkauf*) is not applicable. Hence the tax loss carry forwards are forfeited if the following three criteria are met cumulatively:
  - Substantial change in the economic structure
  - Substantial change in the organisational structure
  - Substantial change in the ownership of the company
- The deduction of interest resulting from the acquisition of shares is generally possible. However, interest cannot be deducted if the seller of the shares is an affiliated company or the acquisition of the shares was financed by an affiliated company and the respective company is subject to low taxation
- The sale of shares is tax-exempt under Austrian VAT legislation. Consequently, input VAT for expenses related to the sale of the shares (e.g. consulting costs) cannot be deducted
- Real estate transfer tax is triggered if 95% or more of the shares in a company which owns real estate in Austria are acquired by a single shareholder or by companies which are members of a tax group pursuant to Sec 9 CIT. Therefore, real estate transfer tax can be avoided through careful structuring. However, no registration duty is triggered due to the acquisition of shares
- In general, no stamp duties are triggered in consequence of a share deal

**Asset deal**

In the case of an asset deal all or specific assets of a company are acquired and the ownership of the assets is transferred through singular succession. The main characteristics of an asset deal are summarised as follows:

- Extensive statutory liabilities e.g. Art 1409 Austrian general civil act (ABGB), Art 38 and 39 Austrian Commercial Code (UGB), Art 6 Labour contract law (AVRAG), § 14 Federal Fiscal Code (BAO), § 67 (4) Austrian General Social Security Act (ASVG) and further contractual liabilities
- The book value of the acquired assets is stepped-up subsequently resulting in a higher depreciation. However, it is to be noted that a higher depreciation may result in a "cash-trap" as the net profit is reduced, which subsequently lowers the level of dividend payments which may be made

- Goodwill can be capitalised and depreciated over 15 years
- Interest resulting from the acquisition of assets can be deducted
- Tax loss carry forwards are not transferred and remain at the level of the seller
- The sale of assets is generally subject to Austrian VAT, although there may be possible tax exemptions depending on the type of the acquired assets. In particular the sale of real estate is tax exempt; however, it is possible to opt to apply VAT to such sales in certain circumstances. Furthermore, input VAT on the purchase of the assets as well as transactions costs may be deducted, if the underlying transaction is not tax-exempt
- The acquisition of real estate in an asset deal triggers real estate transfer tax and registration duty
- Stamp duties for the assignment of receivables to the new owner as well as the extension or amendment of certain agreements (e.g. lease agreements) may trigger stamp duties

## 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?

The step-up of the value of the tangible and intangible assets is only possible by way of an asset deal.

In the case of share deals, a step-up of the book value for accounting purposes can only be achieved through subsequent reorganisations. However, the tax book value is not stepped-up and remains the same. Furthermore, after the conclusion of a transaction it may be possible to revise the applied depreciation policy and to reverse past write-downs, which are, however, taxable. Alternatively the depreciation rate may be extended, which leads to a longer useful life of the assets.

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

Only a derivative goodwill resulting from an asset deal can be capitalised and depreciated. The Austrian tax law prescribes a fixed amortisation period of 15 years for goodwill. It is, however, possible to perform write-downs or a write-off of the goodwill with an immediate tax effect on the basis of an impairment test.

In a share deal no goodwill can be capitalised and depreciated. However, tax deductions can be achieved through write-downs due to an impairment test with certain limitations or as a result of a liquidation.

### 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?

The Austrian corporate income tax law does not contain thin-capitalisation rules. Based on Austrian case law, however, a re-characterisation of intercompany loans to equity is possible under very special conditions (e.g. loan agreement not in line with arm's length criteria, inadequate equity ratio). Interest payments for such re-characterised loans, as well as non-arm's length interest payments are not tax deductible. Furthermore, the following restrictions on interest deduction need to be considered:

- **No interest deduction in case of intercompany share-deals**

Interest payments for (intercompany and external) debt are not tax deductible if the debt was taken out for the acquisition of a participation that was previously owned by a group member or by a shareholder with controlling influence. This rule also applies for capital increases or equity contributions.

- **No interest deduction in case of low-taxed related party recipient**

With effect from 1 March 2014 Austria implemented a targeted interest (and royalty) limitation rule (not limited to the acquisition of participations) which is applicable if the following conditions are fulfilled:

- The recipient is a corporation or a comparable foreign corporation
- The recipient is a direct or indirect member of the same group or controlled directly or indirectly by the same shareholder
- The interest (or royalty) payments are not subject to tax at the level of the receiving entity owing to a personal or objective tax exemption, or if the nominal or effective tax rate (tax refunds are taken into account) is less than 10 per cent

This rule must be applied to the beneficial owner of the interest, therefore any interposed entities are disregarded and the tax regime of the beneficial owner needs to be checked. In the case of transparent entities under Austrian tax law (e.g. partnerships, investment funds, etc) the rule applies to the corporate entity (partner, investor) behind the transparent entity.

As this targeted rule is considered by the Austrian ministry of finance as equally effective as the interest limitation rule as stipulated in Art 4 of the EU-Anti Tax Avoidance Directive, the obligation to implement the interest limitation rule by 1 January 2019 could be deferred (until 1 January 2024 at the latest), however so far no consent of the EU commission on the equal effectiveness has been granted.

- **Limitations on interest deductions in the case of divided distributions**

Interest for debt financed regular dividend distributions are generally tax deductible. No tax deduction is possible if the dividend distribution qualifies as a repayment of equity or in the case of deemed dividends.

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

Generally the Austrian corporate law provides for various restrictions regarding debt push-down securing the interest of debtors. In this respect it is crucial not to violate these obligatory corporate law principles by pushing-down debt (incurred by a parent company) to a subsidiary.

However, in order to push-down debt (economically), an Austrian tax group could be established (see question 17 for details). In a nutshell, the tax group allows the interest expenses from the debt financing of the holding company (group leader) to be offset against the positive income of the group member companies.

Furthermore, a (limited) debt push-down can be achieved by debt financed dividend distributions made by the target.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

The Austrian law provides for the establishment of a Mid-Sized Business Financing Company (MSBFC) for which certain tax advantages are granted. A MSBFC is a vehicle to pool equity capital from different investors in order to invest in companies in start-up or growth phase. In this context the following benefits arise:

- Profit distributions to private investors are tax free up to an amount of EUR 15,000 annually
- At the level of the MSBFC, income associated with finance activities as well as capital gains, capital losses and other value alterations of participations are exempted from CIT

It should be noted that certain requirements have to be met to establish a MSBFC. The Austrian tax law requires the legal form of an Austrian limited liability company (GmbH), stock company (AG) or comparable foreign legal entities, a scope of business restricted to financial activities (at least 75%) and investment activities (up to 25%) of the company's equity, an economically solid investment and associate risk diversification strategy and a shareholder structure of at least five shareholders with no shareholding exceeding 49%.

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

In the case of share deals tax loss carry forwards are generally available and can be offset by the target against future profits (the general limitation applies whereby losses are only deductible up to 75% of the annual profit), provided that the Mantelkauf provision (purchase of corporate shell) does not apply. This provision applies if the identity of the target is lost in the course of the acquisition, which would be the case if the economic structure together with the organisational structure, as well as the ownership structure (against consideration) is substantially (i.e. more than 75%) changed. An exception to the rule exists, if the substantial changes are made in order to facilitate the financial recovery of the company and a substantial part of the workforce is thereby maintained. No transfer of tax loss carry forwards is possible in the case of asset deals.

Loss carry forwards can also be affected (lost) in the course of reorganisations (e.g., mergers, de-mergers, contributions) and therefore need to be considered early in the planning stage.

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

Stamp duties are levied on selected legal transactions that are concluded in written form (e.g. protocols, official documents, easements, lease and rental agreements, guarantee and assignment agreements). The rates vary between 0.8% and 2% of the underlying value of the transaction. In some cases the stamp duties are levied at flat amounts.

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

The Austrian tax law does not provide for transfer taxes or stamp duties on transfer of shares. Furthermore, the transfer of shares is exempt from VAT.

However, Real Estate Transfer Tax ("RETT") is triggered if at least 95% of all shares of a corporation owning Austrian immovable property are held by or are taken over by one shareholder or by members of an Austrian tax group. In addition shares held by trustees are attributed to the trustor or settlor of the trust. RETT is also triggered if 95% of shares of a partnership have been transferred to new partners within the last five years. In the case of a unification of shares, the tax base is always the tax value of the real estate and the tax rate amounts to 0.5%.

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

Acquisition costs are capitalised to the purchased asset, in a share deal and in an asset deal. Shares cannot be depreciated on a regular basis, while assets can typically be depreciated over their useful life. In the case of impairments of participations the impairment amount generally has to be spread over seven years for tax purposes. No tax deductibility of impairments is possible e.g. for international participations where the taxpayer has not elected to opt-out of the participation exemption when the participation was acquired and for participations which are a member of an Austrian tax group. Impairments which are the result of dividend distributions cannot be utilised for tax purposes (i.e. no tax deductibility).

Auxiliary acquisition costs (e.g. due diligence expenses, advisory fees, commission) incurred after a general decision has been made to acquire a company (e.g. date of signing of LoI; the purchase decision does not need to be final) have to be capitalised on the asset and thereafter are treated for tax purposes as part of the asset.

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

In general input VAT incurred on acquisition costs may be deducted, if the buyer is entitled to deduct VAT (e.g. operative company).

However, where the shares or assets are acquired by a holding company, a distinction has to be drawn between non-operating holding companies and managing holding companies. In the case of a non-operating holding company, input VAT on the acquisition costs cannot be deducted, whereas input VAT may be deducted if the holding company is arranged as a managing holding company (*Geschäftsleitende Holding*).

Moreover, share deals are generally exempted from VAT and therefore input VAT associated with this kind of transaction may not be recovered. It should be noted that brokering services for share deals are also exempted from VAT.

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

**Outbound dividends**

- In general, dividends and other profit distributions paid to a resident corporation are subject to a withholding tax of 25%. Withholding tax is not levied on the condition that the direct or indirect shareholding of the resident corporation is at least 10%. In all other cases, the withholding tax is credited against the final tax liability of the shareholder or refunded in the course of the annual tax return.
- Having implemented the EC Parent-Subsidiary Directive into Austrian law, Sec. 94 (2) ITA provides for an exemption of outgoing dividends from withholding tax if (i) the EU parent company has a legal form listed in the Annex to the Directive (Annex II), (ii) the EU parent company owns at least 10% of the capital of the subsidiary and (iii) the shares have been held directly or directly (via a tax transparent partnership) for an uninterrupted period of one year. The exemption is not applicable in the case of tax avoidance and abuse of law or in the case of deemed dividend distributions. Generally, tax avoidance or abuse of law is not assumed if the EU parent company provides its Austrian subsidiary with a confirmation stating that it derives income from an active business, employs its own personnel and maintains its own business facilities. The Austrian Ministry of Finance provides for the special form “ZS-EUMT” to be used in this case.
- Beyond the scope of the EC Parent-Subsidiary Directive, relief from withholding tax on outbound dividends may be provided by applicable tax treaties. Generally speaking, reduction (or even exemption) of withholding may be granted at source only if the receiving (foreign) corporation runs an operating business and has its own personnel and premises. Otherwise, treaty relief may be granted by way of a refund procedure.
- Furthermore, according to Sec. 21 (1) (1a) CITA a non-resident corporation may claim a refund of the total amount of the Austrian withholding tax under the following conditions:
  - The foreign corporation is resident in the EU or Norway
  - Under a tax treaty, the foreign corporation cannot – verifiably – wholly or partly credit the Austrian with-holding tax in its residence state

**Capital gains**

Capital gains of a non-resident corporation resulting from the alienation of a participation in an Austrian corporation (such as GmbH or an AG) are taxable in Austria at a rate of 25% if the shareholding amounts to at least 1% of the capital of the corporation at any time during the five preceding years. However, applicable tax treaties following the OECD model convention usually prohibit Austria form taxing the capital gain.

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

Under general income tax principles, a reorganisation of companies normally constitutes a taxable event and triggers the realisation of hidden reserves of the assets transferred in the course of the reorganisation. However, the Reorganisation Tax Act (RTA) – which is based on the EC Merger Directive 90/434/EEC – provides for a special tax regime applicable to the following types of reorganisations:

- Mergers
- Conversions
- Contributions of assets
- Formation of partnerships
- Divisions of partnerships
- Demerger of corporations

The RTA basically provides for the following tax treatment, subject to certain conditions:

- No liquidation taxation due to the reorganisation (neither on the level of the company/partnership nor on the level of the shareholder/partner)
- Tax-neutral transfer of assets
- Transfer of loss carry-forwards to the receiving entity (under certain limitations)
- Beneficial rules as to the tax base for real estate transfer tax purposes
- Exemption from value added tax

The RTA allows reorganisations with retroactive effect (basically within a nine-month period), as well as multiple reorganisations at the same effective date.

Binding rulings are available in reorganisation issues (costs amounting to between EUR1,500 and EUR 20,000 depending on the turnover of the requesting taxpayer).

For tax grouping, see question 17.

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

Generally, the Austrian tax law does not provide for special provisions for real estate companies. However, the following aspects should be considered:

- **Real Estate Transfer Tax (RETT):** RETT at a rate of 3.5% is levied on transfers of immovable property (land and buildings) located in Austria. Furthermore, RETT is triggered if at least 95% of all shares of a corporation owning Austrian immovable property are held by or are taken over by one shareholder or by members of an Austrian tax group. In addition shares held by trustees are always attributed to the trustor or settlor of the trust. RETT is also triggered if 95% of shares of a partnership have been transferred to new partners within the last five years. In the case of a unification of shares, the tax base is always the tax value of the real estate and the tax rate amounts to 0.5%.
- **Real estate investment funds:** Austrian tax law provides a special tax regime for real estate investment funds, which prevails over domestic tax and tax treaty rules. In short, if the regime is applicable, the fund vehicle will be treated as tax-transparent with the investors in the fund becoming subject to Austrian limited tax liability on so-called "deemed distributions". In particular, the taxation of deemed distributions provides for the taxation of annual pro-rata unrealised capital gains and interest on shareholder loans, which would be deemed rental income from Austrian situs real estate. The fund tax rules are based on a substance-over form approach, which means that companies interposed between the fund and the real estate object may be, in general, disregarded for fund tax purposes. In the case of an Austrian corporation held by the fund, unrealised capital gains are attributed to the fund and are taxable at the level of the unitholders. In the case of a partnership or a foreign corporation, the latter is just treated as transparent.

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

Yes, there is a tax grouping regime in Austria. In order to establish a tax group there must be an Austrian corporation or a permanent establishment of an EU corporation registered in Austria holding a (direct or indirect) participation of more than 50% of the capital and the majority of the voting rights in a domestic or foreign corporation. The minimum holding requirement for the group leader can also be met together with other unrelated companies provided the shareholding of one corporation amounts to at least 40% and the shareholding of the other corporation amounts to at least 15%.

A tax group has the benefit that all profits and losses of domestic group members are allocated for tax purposes to the group leader. The group may also include first-tier comparable foreign corporations which are resident in the EU or in a country that has concluded a comprehensive administrative assistance agreement with Austria. Only losses of foreign group members may be deducted from the taxable income of the group in proportion to the amount of the direct shareholding of the group in the foreign entity. However, please note the following limitations with respect to foreign losses:

- The deductibility of foreign losses derived through non-resident group members is limited to the amount as calculated under foreign rules. The foreign losses are recaptured and taxed in Austria in subsequent years if and to the extent they can be offset against profits of the foreign entity under its domestic tax regime or if the foreign entity drops out of the group (e.g. due to sale of the participation or if the foreign company is deemed to be liquidated). Profits of foreign group members are not to be included in the tax group.
- The deduction of losses from foreign group members against the tax group's profit is capped at 75% of the profit of all domestic group members (including the group leader). The remaining loss surplus may be carried forward by the group leader.

Providing that all requirements are fulfilled, the group leader may opt for group taxation simply by filing an application form with the tax authorities (subject to certain time constraints). The tax authorities approve the tax group by official notice. The tax group has to remain in existence for at least three years. If the tax group is terminated earlier, all benefits from the group taxation will be lost and each member of the group will be taxed as a separate entity with retroactive effect.

Binding rulings are available in group taxation issues (costs amounting between EUR 1,500 and EUR 20,000, depending on the turnover of the requesting taxpayer).

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

Austria does not have any special tax status or patent box regime in place. Instead, Austria promotes research and development activities by allowing an immediate tax deduction for R&D expenses and additionally granting a special R&D tax relief. The tax credit for R&D takes the form of a cash tax credit and amounts to 14 per cent of R&D expenses. The cash tax credit is granted for in-house and contract R&D, however, only expenses of up to €1 million per year may be considered as the base for the cash tax credit in case of contract R&D (no limitation for in-house R&D expenses).

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

**Private assets**

Exit tax applies to financial instruments, derivative contracts and derivative financial instruments. Therefore emigration will trigger income tax of 27.5% on unrealised capital gains from financial instruments as well as shareholdings. In the case of the transfer of financial assets which are part of the non-business assets of an individual taxpayer, the income tax may be assessed, but will be deferred without late interest payment until disposal in cases of (i) individuals moving abroad or (ii) gratuitous transfer of private assets to individuals. In other situations, where Austria's right to tax with respect to such private financial assets will be lost or restricted due to transfer to an EU/EEA state, an instalment payment regime applies for the incurred tax over a period of seven years (five years for exits after 31 December 2018 based on new draft tax legislation). The statute of limitation (ten years) can no longer be applied to exits after 31 December 2005 Consequently, exit taxation for such cases can only be suspended but not ultimately avoided.

**Business assets**

Exit tax applies to the transfer of business assets to foreign countries of individuals, partnerships or corporations. In the case of the transfer of business assets (not exclusive to financial assets) to an EU/EEA, an option is available to apply for the payment of instalments of the incurred exit tax. This option is possible in cases where a taxpayer transfers assets to another business of the same taxpayer or transfers an entire business. The instalment period generally amounts to seven years (five years for exits after 31 December 2018 based on new draft tax legislation) and two years for current assets.

## 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?

### Share deal

- Capital gains generated by Austrian resident individuals on the sale of shares in a corporation are generally taxed at a flat rate income tax of 27.5%
- Capital gains generated by an Austrian resident corporation on the sale of shares in a corporation are generally subject to 25% CIT
- However, capital gains resulting from qualified international participations (*internationale Schachtelbeteiligung*) are exempted from Austrian CIT. An international participation requires an Austrian resident corporation to have a direct or indirect participation of at least 10% in a foreign corporation for a minimum uninterrupted period of one year. Furthermore the legal form of the foreign international participation has to be comparable to Austrian corporations or has to be listed in Art 2 in the Annex to the EC Parent-Subsidiary Directive. It should be noted that suffered losses, except ultimate liquidation losses, cannot be offset against other income correspondingly. It is possible to opt-out from this tax neutrality for each international participation separately in the respective tax return in the year of acquisition, thus making gains and losses from this participation taxable
- Capital gains of non-resident corporations or individuals resulting from the alienation of participations in Austrian resident corporations are principally taxable in Austria, if the shareholding amounts to at least 1% in the capital of the corporation at any time during a time period of the preceding five years. Nevertheless, double tax treaties usually prohibit Austria from taxing if they contain an OECD Model-type capital gains provision
- Capital gains from an M&A process aren't eligible for special treatment.

### Asset deal

- Capital gains generated by Austrian resident individuals from the alienation of assets are generally taxed at the progressive income tax rate (up to 55%)
- Capital gains generated by an Austrian resident corporation from the alienation of assets are generally subject to 25% CIT
- Due to the tax transparency of Austrian partnerships, the sale of shares in an Austrian partnership is classified as an asset deal (sale of the assets of the partnership)

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

- Generally no fiscal advantage is granted to corporations in respect of the reinvestment of sales proceeds.
- Nonetheless, a special rollover relief is available for private foundation (*Privatstiftung*) regarding the reinvestment of capital gains in participations under Sec 13 (4) CITA. Hidden reserves resulting from the alienation of participations that are held as non-business assets can be transferred to the investment cost of new participations. Technically the capital gain is deducted from the acquisition costs of the new investment, lowering the amortization base, but not resulting in an immediate taxation of the realised hidden reserves.

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

The Austrian tax law generally applies a substance over form approach. Consequently, any transaction is attributed to the beneficial owner rather than to the legal owner. Thus, generally a look through approach is applied to transactions involving strawmen or back-to-back structures. To be considered a beneficial owner the entity generally needs to have the resources and the capacity to control the investment and the related risks (i.e. rented office space, staff).

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

The Reorganisation Tax Act (RTA) – which is based on the EC Merger Directive (90/434/EEC; see Annex III) – provides for a special tax regime applicable to mergers and spin-offs. Consequently mergers and spin-offs can be conducted tax neutrally. Nevertheless, special attention should be paid to loss trafficking rules, exit taxation, RETT and possible VAT correction.

# MANAGEMENT INCENTIVES

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

Generally executives obtain income from employment activities and are taxed as employees or they generate income from independent professional services and are taxed accordingly under the rules regarding business profits. The generated income includes all remuneration, in cash or in kind, derived by an employed person and paid by the employer or by a third party. The personal income tax (PIT) is levied under progressive rates. Austrian tax law provides a PIT exemption for benefits received annually of up to EUR 3,000 from an employee participation program. In this regard, benefits of the employee arising by granted shares at a discounted price or free of charge by the employer are exempted from PIT provided the following requirements are met:

- The shareholding has to be received from shares in the employer company or a related group member
- The shares must be delivered gratuitously or at a reduced price
- Approved form of shares are holdings in AG or GmbH; real silent participation etc (partnerships are excluded)
- Benefit has to be granted at least to a specific group of employees
- Shares must be held for minimum period of five years
- Valid contract of employment

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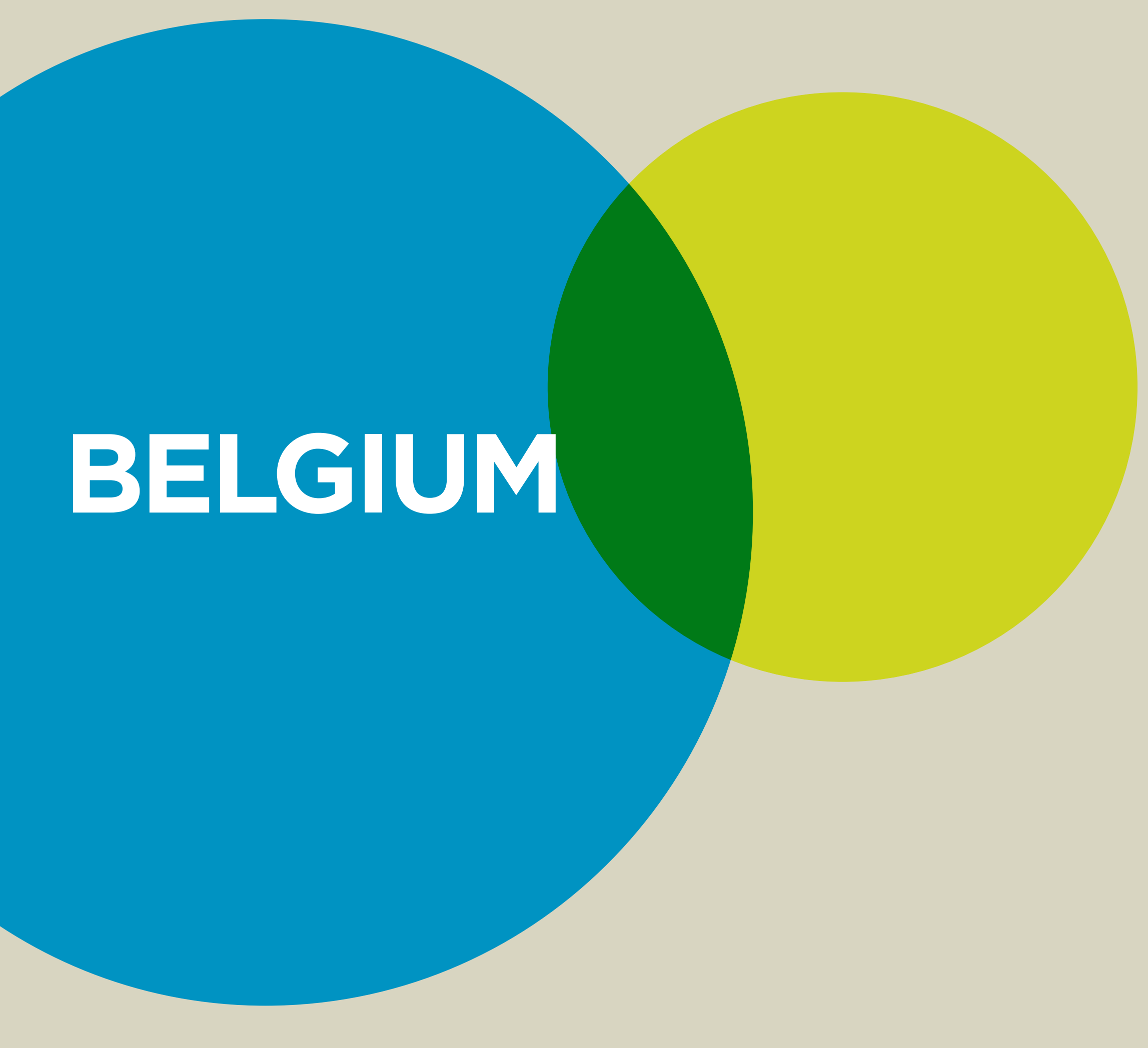
# BELGIUM



# BELGIUM

## INTERNATIONAL DEVELOPMENTS

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

A major corporate income tax reform has been published in the Belgian Official Gazette on 29 December 2017. The decrease of the corporate tax rate is one of the key elements of this reform, along with several other measures aimed at making Belgium more attractive for businesses and investors. At the same time, the tax reform also includes a series of so-called "compensating measures" in order to reduce the cost of the tax reform for the State Treasury.

Following the corporate income tax reform, as of 2018, the standard corporate tax rate is 29,58% (instead of the recently applicable rate of 33,99%). For SMEs (small and medium-sized enterprises) a reduced tax rate of 20,40% is introduced on the first bracket of 100.000 EUR on taxable profits. The amount of taxable profits exceeding 100.000 EUR, will be subject to the standard corporate tax rate. As of 2020, the standard corporate tax rate will be reduced to 25%.

### 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?

The Minister of Finance has announced – concerning the introduction into Belgian tax law of the BEPS Actions 6 and 15 – that any modifications of existing tax treaties or conclusion of new tax treaties will be subject to the inclusion of additional anti-abuse rules based on the BEPS guidelines.

Please note that the Belgian standard double tax treaty model already includes a subject-to-tax clause for the prevention of double taxation.

Belgium has implemented the anti-hybrid provision of Directive 2014/86/EU of 8 July 2014 in its internal tax law. Indeed, no "dividends received deduction" is allowed for dividends paid by a company to the extent that such income has been or can be deducted from the profits of the latter company.

Furthermore, a new general anti-abuse rule has also been introduced into Belgian tax law. The dividends received deduction or the withholding tax exemption will not be granted where there is a legal act or a series of legal acts which have been carried out purely for tax purposes and which are not motivated by any business reasons.

The recent corporate income tax reform provides for the implementation of the European Anti-Tax Avoidance Directives I and II. The CFC, exit taxation and hybrid mismatches measures will take effect in 2019 and the interest limitation deduction will enter into force in 2020.

## GENERAL

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

**A) Share deal**

In the case of a stock acquisition, the acquiring company is not entitled to depreciate the assets of the target company, nor the acquired shares in the target company, which might lead him to prefer an asset deal instead.

In most cases, however, the seller will prefer to carry out the transaction by means of a sale of stock, as capital gains on shares are in principle 100% tax exempt, where certain conditions are met (see also question n° 20).

Individual sellers in principle also still benefit from an exemption from tax on the capital gain (when the capital gain is realised as a result of the 'normal management' of the seller's private portfolio and does not concern a substantial shareholding sold to a buyer established outside the European Economic Area).

As of 1 January 2017, new rules on contributed capital gains have been introduced, including a new definition of fiscal capital. As a result, if an individual taxpayer contributes shares into a company and if the capital gain realised upon such contribution is tax exempt, the acquiring company will only enjoy an increase of its fiscal capital in an amount equal to the acquisition value the shares had in the hands of the individual. The excess part of the contribution will be considered to be a taxable reserve.

**B) Asset deal**

In the case of an acquisition of business assets, the acquiring company is in principle authorised to depreciate the acquired assets and goodwill or clientele on the basis of the acquisition value. This means that the acquiring company will benefit from a fiscal step-up that reflects the difference between the sale price of the transfer of assets and liabilities and the fiscal value of these assets and liabilities prior to the sale. As a result, the acquiring company usually prefers an asset deal.

On the contrary, upon a sale of business assets, the seller will in principle be taxed on all capital gains realised. It should be noted that capital gains realised on business assets may however benefit from a deferred taxation regime (see also question n° 21).

## 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 stock acquisition does not change the fiscal identity of the target company. As such, the company's assets and liabilities will not acquire a different tax status. The target company will continue to depreciate or evaluate its assets as it did before the acquisition.

Often, a taxable merger can be considered to unite the target company and the acquiring company into one single company. Such taxable merger leads to a taxation of the absorbed target company's assets, but it may be possible to use the existing carried forward losses in the target company to offset against the profits or capital gains realised by the target company upon the taxable merger, and at the same time realise a step-up on the assets transferred by the target company into the acquiring company.

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

A buyer who has acquired goodwill is entitled to a fiscal step-up. This is because the Belgian Income Tax Code allows the acquiring company to depreciate all acquired assets in accordance with their acquisition value, including the value attributable to goodwill. Additional costs incurred on the asset can be depreciated as well, either in the year in which these costs have been incurred, or on a pro rata basis. This is also in accordance with the depreciation method applied to the assets to which these additional costs relate.

To determine the depreciation methods, tax law in general refers to the principles of accountancy law. As a result, the depreciation period is in principle determined by the normal economic life expectancy of the assets concerned. However Belgian tax law specifically provides for a minimum depreciation period of five years for intangible fixed assets (such as goodwill and clientele). Often tax authorities attempt to impose a depreciation period of 10 to 12 years for depreciations on clientele. In practice, and to avoid any dispute with the tax authorities, taxpayers will need to demonstrate that their clientele is of a more 'dynamic' nature and that the depreciation period should therefore be shorter than 10 or 12 years.

## 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?

As a general rule, taxpayers are allowed to 'deduct all costs incurred to acquire or to maintain taxable income'. This rule also applies to interest or financing costs incurred to acquire stock or assets. Therefore there is no difference in tax treatment between a share or an asset deal.

Belgian tax law however provides some general provisions that limit the tax deduction of financing costs. Interest is not tax deductible when the interest rate is not set in accordance with normal market conditions, taking into account the specific transaction risk and the financial position of the debtor. Also interest is not tax deductible when paid to a foreign taxpayer or to a foreign establishment that is not subject to income taxation in the foreign jurisdiction. This is also the case if it is subject to a much more favourable tax regime than the Belgian income tax regime unless the taxpayer can prove that the interest payments relate to true and sincere transactions and do not exceed normal market limits.

A special 'thin capitalisation' rule also applies for corporate taxpayers (who also remain subject to the above restriction rules) regarding interest payments made to beneficiaries not subject to income taxation or subject to a much more favourable tax regime than the Belgian tax regime or related companies. Such interest payments cannot be deducted by the corporate taxpayer if and insofar as the total loan amount exceeds five times the total sum of the taxed reserves at the beginning of the taxable period plus the amount of paid-in capital at the end of this period (this is the so-called 5:1 debt-equity ratio). Furthermore, the same debt-equity ratio of 5:1 also applies to loans granted by related parties.

Furthermore, a debt-equity ratio of 1:1 applies if the lender is a non-European based company acting as a member of the board of directors, a liquidator, or a person exercising similar functions in the Belgian company. Belgian tax law states that interest payments on loans which are granted by a member of the board of directors, the liquidator, or a person exercising similar functions in the company will, for tax purposes, be re-characterised as "dividends" to the extent that the interest payments exceed a certain threshold. The threshold is exceeded when the interest rate is higher than the market interest rate, or, when the amount of the loan is higher than the sum of the taxed reserves at the beginning of the taxable period and the paid up capital at the end of the taxable period. In such case, the amount of interest exceeding the thresholds will be considered a dividend and will not be deductible from the taxable income of the Belgian company.

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

Performing a debt push-down in general is often considered to be a fiscal 'necessity' due to the absence of a fiscal unity for Belgian income tax purposes. Such debt push-down is achieved by consolidating the financial costs of the acquiring company with the profits of the target company, often by means of a national or cross-border merger. However, in order to perform a tax neutral merger, the merger needs to pass a business test and cannot be solely inspired by tax motives (which in many cases are the only real motives for the merger). The latter condition may jeopardise the potential to perform the merger in a tax neutral manner.

However, a merger between the buyer's (intermediary holding) company and the target company may offer a solution that can result in an effective debt push-down. This is because the merger will result in the profits and costs of both companies remaining taxable and deductible within the one single taxable entity, i.e. the company resulting from the merger operation.

Other debt push-down strategies may be to charge management fees to the target company or perform a debt push-down by putting in place intra-group loans. A dividend distribution or capital decrease may also be considered as an alternative. Please note that such alternative strategies will need to comply with economical substance rules and transfer pricing regulations.

Please note that as part of the recent corporate income tax reform, a tax consolidation regime will be introduced as of 1 January 2019.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

The most applied tax incentive is the notional interest deduction. By applying the notional interest deduction, Belgium aims for equal treatment between finance raised through venture capital and finance raised through debt funding. Due to several modifications of the notional interest deduction, the regime has become less attractive. In this respect, the method of calculating the notional interest deduction has recently been changed. As from 1 January 2018, the notional interest deduction is calculated based on the incremental equity (over a period of 5 years) (instead of on the total amount of the company's qualifying equity), meaning that only the average increase of the qualifying equity will qualify for the application of the notional interest deduction. On this amount a specific percentage is applied; for tax year 2019 this percentage equals 0.746% (1.246 for SMEs).

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

Following an acquisition, tax losses carried forward are in principle lost due to the change of control of the company. That is unless the company can show that the acquisition was performed in accordance with 'legitimate financial or economic needs'.

Many disputes and court cases have resulted from the fact that the events or circumstances that represent a 'legitimate financial or economic need' are not specified in the text of the law. Recent jurisprudence has confirmed that a takeover designed to prolong the existence of the company (even in cases where new activities are carried out by the company after the change of control) can constitute such legitimate financial or economical motive. In order to obtain certainty on the possibility to maintain the available tax losses, the parties can request an advance tax ruling.

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

The tax authorities have been showing an increased interest in transfer pricing topics during tax inspections. Also, with effect from the 2017 tax year, transfer pricing documentation obligations have been introduced in Belgium. The Belgian rules are based on international transfer pricing documentation guidelines and more specifically on Action 13 of the OECD's BEPS action plan. The rules comply to a large extent with the three-tier transfer pricing documentation requirements imposed on multinational enterprises by the OECD guidelines: master file, local file and country-by-country reporting.

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

Transfer taxes are due when immovable property (houses, land, industrial facilities, etc.) is involved. The registration duties amount to 10% when the property is located in the Flemish region. In this respect, please note that as of 1 June 2018 (expected date) the registration duties will amount to 7% when the property is located in the Flemish region, it is a first house and the buyer will live in it within 2 years. An additional discount will apply for modest houses. Where the conditions to benefit from the 7% rate are not fulfilled, the 10% rate will apply. The registration duties amount to 12.5% when the property is located in the Brussels or the Walloon region.

However, 'new' buildings can be transferred under the VAT regime instead of incurring registration duties, in which case the sale is subject to VAT at 21%. When the acquiring company is entitled to deduct VAT, such a 'VAT-sale' may be more advantageous. Indeed, when the acquiring company is entitled to deduct input VAT and uses the acquired immovable property for activities subject to VAT, the paid input VAT can be recovered by reclaiming it in the VAT return relating to the period in which the transfer took place.

In principle, the transfer of all other – movable – assets will be subject to VAT. However, an exemption applies when the assets form a 'universality of goods' or 'branch of activities'.

Share deals are in principle not subject to any transfer tax, except for the 'stock exchange tax' (various rates apply, depending on the nature of the security concerned). However various exemptions apply.

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

Acquisition costs are, as any other cost, deductible provided the taxpayer can establish that said expenses or costs were incurred during the taxable period in order to acquire or at least preserve taxable income. Also, the reality and the amount of the expense needs to be justified as being "reasonable" (the taxpayer may deliver this proof by all means of law). An expense will however not qualify as tax deductible if the sole purpose of the expense is transferring taxable profits from one company to another.

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

For asset deals, the normal VAT deductions apply. When the acquiring company is entitled to deduct input VAT and uses the acquired assets and services for activities subject to VAT, the paid input VAT can be recovered by reclaiming it in the VAT return relating to the period in which the transfer took place.

For share deals, the answer is less certain. In general, however, if the acquisition costs are part of the company's general business costs and are as such incorporated in the general turnover rendered by that company to third parties or other group companies, the input VAT on these costs will be deductible (depending on the company's overall right to deduct input VAT). If these costs however relate to an isolated purchase and sale of shares or participation, the input VAT incurred on these costs may not be deductible since it will be considered as a financial transaction for which no input VAT recovery is granted.

Recent jurisprudence has confirmed the right to deduct VAT on costs related to the acquisition of shares when it could be established that there is a direct link between the acquisition and the taxpayer's economic activities.

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

When a foreign company acquires a Belgian company, the main tax consequences thereof will of course need to be verified in its own country of residence.

However, from a Belgian perspective there are a few elements to take into account, such as the aforementioned debt-equity ratios and loss limitation rule.

In addition, it will in any event be important to make sure that the Belgian company has sufficient substance following the take-over so that arguments cannot be raised to the effect that the company is no longer Belgian resident. In that respect, we usually recommend that all shareholder's and board meetings are physically held in Belgium and that all important decisions are taken from the Belgian offices.

The acquiring company itself should in principle not be afraid of becoming subject to Belgian taxation, unless of course a Belgian permanent establishment would be created upon or following the acquisition.

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

A common post-acquisition restructuring is the merger of the acquiring company and the Belgian target company, certainly when a Belgian intermediary holding company (SPV) has been used by a foreign buyer to acquire the Belgian target company.

A tax neutral merger between two companies is possible if certain conditions are fulfilled:

- The acquiring company must be a Belgian or a European resident company
- The merger is carried out in accordance with the Belgian Code of Companies or similar corporate rules applying to the acquiring company
- Tax fraud or tax evasion cannot be the main reason or one of the main reasons for the merger. It is therefore necessary to establish that business motives (other than tax motives), such as restructuring, simplification of the group structure or rationalisation of activities have motivated the merger operation

The burden of proof in principle lies with the tax authorities: the tax authorities have to prove that tax fraud or evasion is the main objective or one of the main objectives in order to deny the tax neutral character of the merger. However, tax fraud or evasion is deemed to exist if the tax authorities can prove the absence of business motives. The taxpayer may refute this presumption by giving considerations, other than tax-inspired ones.

If the acquiring company is a non-Belgian company resident in another EU Member State, the tax exemption only applies to assets that remain allocated to a 'Belgian establishment' that the foreign company avails of after the merger operation.

Various other alternative reorganisations may be considered (such as the transfer of activities), but many of these alternatives are often complicated to implement from a commercial point of view. Please note that these alternatives also need to comply with economical substance rules and transfer pricing regulations.

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

When real estate is included in the transaction a transfer of shares may be a more tax-advantageous way to proceed since a transfer of real estate is subject to registration duties (the rate depends on the location of the real estate in Belgium) or VAT where a new building is concerned (21%). A transfer of shares in general can be effectuated without any transfer tax being due (also see question n° 11).

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

For direct income tax purposes, Belgium tax law does not yet provide the possibility of creating a fiscal unity. Please note that as part of the recent corporate income tax reform, a tax consolidation regime will be introduced as of 1 January 2019. This consolidation will however only operate through so-called "group contributions" and will not represent an overall consolidation of all profits and losses. Qualifying companies will be able to transfer group contributions to other qualifying group companies which can offset the profits resulting from these contributions against tax losses. The contributing entity should also make a payment to the receiving entity for an amount equal to the corporate tax saving. This amount is to be exempt by the receiving entity and constitutes a non deductible item for the paying entity.

For VAT purposes, it is possible to enter into a VAT unity. The latter is often elected in order to avoid or reduce intra-group invoicing or to optimize the deduction of VAT paid on costs or investments.

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

On 2 February 2017, the Chamber of Representatives approved the Innovation Deduction ("ID") bill proposed by the Belgian Government.

The new ID regime allows an 85% corporate income tax deduction of the net income resulting from innovation investments.

More specifically, the new ID regime applies retroactively and as of July 2016 on, amongst other items, patent income and on supplementary protection certificates.

The new ID regime applies on the obtained or received net income. The net income needs to be calculated for each separate tax year and for each intellectual property right.

The ID regime only applies on intellectual property rights which are the result of R&D efforts and investments that the corporate taxpayers committed to, either by themselves, or by engaging non-related companies or third parties (such as universities or independent research centers). In order to quantify this tax deduction limitation, the law provides for a corrective fraction or "Nexus ratio" to be calculated on the qualifying net income.

The ID amounts which cannot be deducted from the corporate taxable income of a specific tax year can be transferred to subsequent tax years

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

The general anti-abuse rule should be kept in mind. This rule makes a (series of) legal acts not opposable to the tax authorities when the tax authorities can prove, based on objective circumstances, that tax abuse exists. Tax abuse is present in cases where taxpayers carry out a transaction that allows the taxpayer to avoid tax or claim a benefit that is contrary to the purpose/legislative intent of the provision of the law. The taxpayer can demonstrate that his choice is mainly motivated by non-tax reasons.

Furthermore, the general transfer pricing rules should be respected, i.e. the price and conditions of the transfer should be at arm's length.

# 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 realised by a corporate taxpayer are in principle deemed profit and are therefore taxable at the normal corporate income tax rate of 29.58%. However, capital gains on shares are in principle tax exempt.

Capital gains on shares are (as a general rule) fully exempt if the following conditions are met:

- The shares must have been issued by companies subject to a normal tax regime (the taxation condition)
- The shares must have been held in full ownership during an uninterrupted period of one year (the holding condition)
- The parent company should comply with a minimum participation threshold of at least 10% in the share capital of the subsidiary, or the shares need to have an acquisition value of at least 2,500,000 EUR (the minimum participation condition)

The current tax regime of capital gains realised by corporate taxpayers can be summarised as follows:

- Full exemption of capital gains on shares if the taxation condition, the holding condition and the minimum participation condition are met
- Taxation at 25.50% of capital gains on shares when only the taxation and the minimum participation condition are met, but not the holding condition - the rate of 25.50% does not apply if and to the extent that the capital gains are eligible for taxation at the reduced rate of 20.40% for SMEs (as defined in the Belgian Company Code)

- Taxation at the standard corporate income tax rate of 29.58% of capital gains on shares when the taxation condition and/or the minimum participation condition are not met (regardless of the holding condition) – for SMEs, the 20.40% rate may also apply

Capital gains on shares realised by individuals are fully tax exempt, unless they qualify as professional or diverse income.

Therefore capital gains on shares realised in the course of a professional activity are taxable as ordinary professional income at the normal (progressive) tax rates.

Capital gains realised within the normal management of the person's private estate are in principle fully exempt. That is, unless the shares represent a 'substantial shareholding' of more than 25% of the share capital of a Belgian company and they are transferred to an acquirer outside the European Economic Area. The latter gains are taxed at 16.5%.

Capital gains falling outside the scope of 'normal management' are taxed as speculative income at a separate rate of 33%.

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

For capital gains realised on shares, Belgian tax law does not provide for any specific method to defer or avoid taxation – if applicable.

By contrast, when a capital gain is realised on business assets, Belgian tax law does provide for a deferred taxation regime whereby the capital gain is not taxed immediately, but on a future pro rata basis. When the capital gain is realised on tangible or intangible fixed assets included in the vendor's balance sheet for more than five years, the capital gain will be taxed on a deferred basis following the depreciation of the reinvestment assets. However this is provided that the purchase price of the assets is fully reinvested in depreciable fixed assets used within a Member State of the European Economic Area for the carrying out of the vendor's business activity. Please note that this reinvestment needs to be carried out within a certain period of time (in principle within three years, but extended to five years for reinvestments in buildings, vessels or airplanes).

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

In order to qualify as a Belgian tax resident company, a company will need to comply with the substance requirements of Belgian tax law: the company must have its registered seat, principal establishment or seat of management or administration in Belgium. As a result, when you wish to set up a Belgian tax resident company, it will be important not only to incorporate the company in accordance with Belgian company law provisions and have the seat of the company registered in Belgium, but also to make sure that the company is effectively managed in Belgium (e.g. board of directors' meeting is held in Belgium physically, all management decisions are effectively decided upon out of the Belgian office…). In an international context, also the tax residency rules included in the Double Tax Treaties to which Belgium is a party, will also come into play. These Double Tax Treaties mainly provide the 'place of effective management' as the main criterion to determine a company's tax residency.

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

As previously mentioned, a merger can be performed in a tax neutral manner when the following conditions are met:

- The absorbing company is a Belgian resident or "intra-European" company
- The transaction is performed in accordance with Belgian company law provisions or –if applicable– the corresponding provisions applicable to the absorbing intra-European company

- The transaction does not have tax fraud or tax evasion as (one of) its main objective(s) (this is the so-called anti-abuse provision of article 183bis ITC)
- The transaction must be performed solely for newly issued shares

The business purpose test is the most important. As a result of this, tax motives may not be the main purpose of the merger, but valid business purposes need to be demonstrated.

Please note that it is possible to ask for a ruling decision with regards to the fulfillment of the business purpose test.

## MANAGEMENT INCENTIVES

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

Special and favourable rules on stock options and share option schemes are included in Belgian law (Law of 26 March 1999). As a result, the options concerned will become taxable at the moment they are granted to and accepted by the beneficiary, even if the options cannot be realised or vested at such moment.

Article 42 of the Law of 26 March 1999 provides for a legal assumption that the options are deemed to be granted 60 days after the moment the options were offered to the beneficiary, provided the beneficiary formally accepts the offer within a period of 60 days (even if the offer is subject to the fulfillment of certain conditions). Where the beneficiary did not communicate his acceptance of the offer within the 60-days period, the offer is deemed to be declined for tax purposes and the favorable tax regime will not apply.

Article 43 of the law of 26 March 1999 provides for specific valuation principles. For instance, *options that are traded on the stock exchange are valued* at the last closing price of the option prior to the day of the offer. For all other options, the taxable amount equals a lump sum percentage of the underlying shares:

- The fixed percentage referred to above amounts to 18%
- The percentage may however even be reduced by half if certain conditions are met

In this respect, please also note that the Belgian tax authorities have recently clarified the tax regime applicable to share options which are granted to the director of a management company by a company to which the management company renders services.

At the end of 2016, the Minister of Finance created some doubt on this issue by questioning whether the favorable tax regime on share options could be applied in cases where the manager personally did not render the services, but instead supplied the services through a management company. In the latter case, it has not complied with the legal condition that the options must refer to the "shares of the company to which the professional activity is performed". Indeed, it is not the beneficiary / director who supplies services to the company granting the share options, but instead the management company.

The Circular Letter clarifies the administrative position in this respect, and confirms that the favorable tax regime also applies in cases where the share options are directly granted to the director of the management company. In such a case, the fiscal value of the advantage in kind which is granted to the director of the management company is deemed to be equal to 18% of the value of the underlying shares and to that extent constitutes a taxable income to the director.

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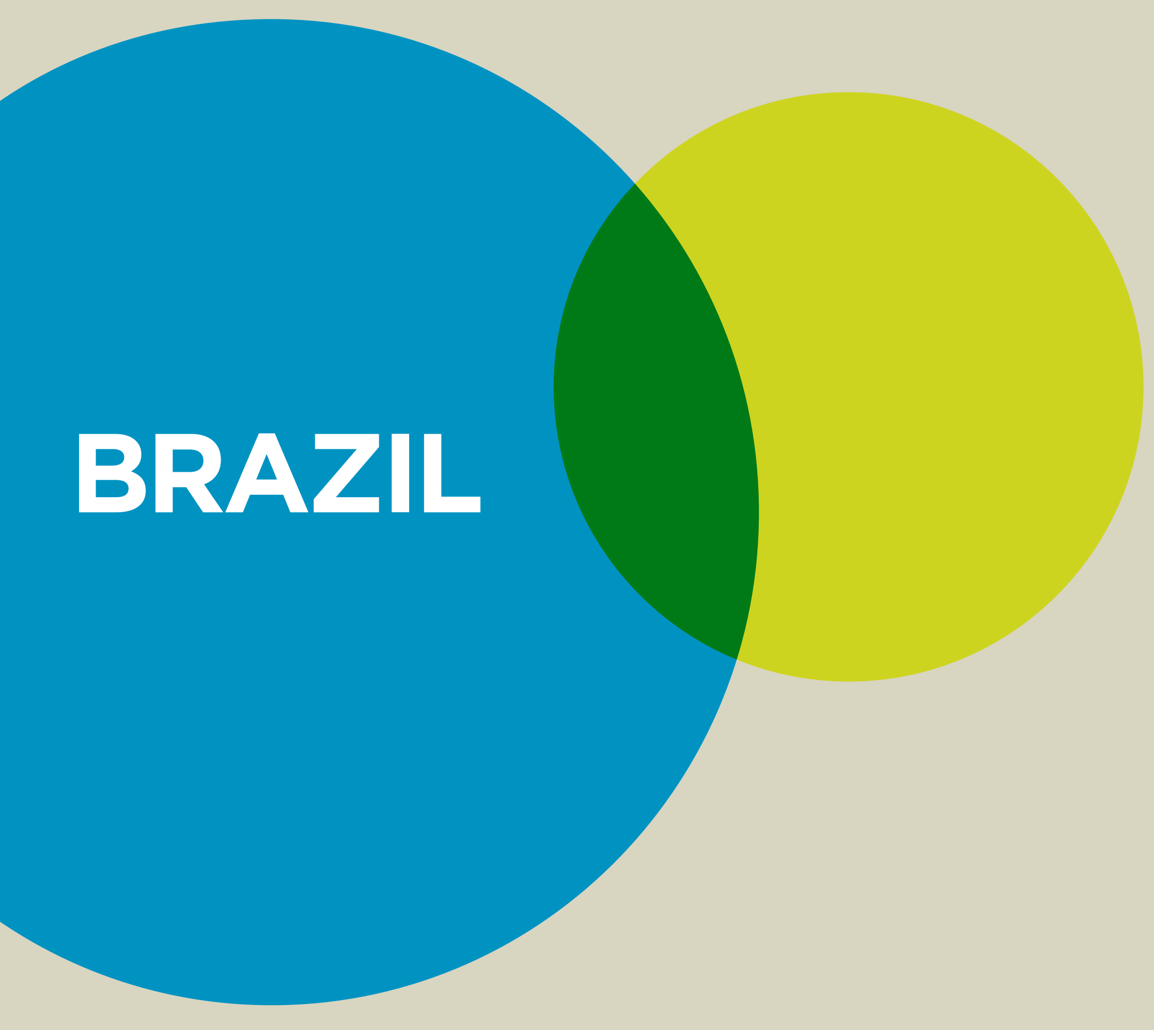
BRAZIL

# BRAZIL

## INTERNATIONAL DEVELOPMENTS

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

The Normative Instruction 1,634/2016, issued by Brazilian Federal Revenue Service ("RFB") have established the obligation to disclose the ultimate beneficial owner for some entities before Brazilian Corporate Taxpayers' Registry ("CNPJ") as of 1 July 2017, for those companies which had applied for registration as from this date. On the other hand, for those companies which had already a CNPJ prior to 1 July 2017, they must disclose the information regarding the ultimate beneficial owner when occur the first of these two hypotheses: (i) when the companies update their records with the CNPJ or (ii) until 31 December 2018.

It is important to mention that, for Brazilian legislation purposes, this obligation is applicable for the following companies: (i) companies registered in Brazil, (ii) clubs and mutual funds authorised by Securities and Exchange Commission ("CVM"), (iii) entities headquartered abroad that owns rights over real estates, vehicles, ships, airplanes, bank accounts, financial investments in the capital market or equity participation in Brazil, (iv) companies which perform external financial leasing, (v) companies which perform chartering ships, (vi) companies which rental equipment, (vii) importation of goods without exchange cover as a capital contribution, (viii) foreign banks that trade currencies with Brazilian banks and (ix) ostensive partner of *Sociedade em conta de participações ("SCP")*.

According with article 8º of the mentioned NI, the ultimate beneficial owner is considered as individuals and certain entities that, directly or indirectly, hold, control or have significantly influencing over an entity, which is presumed in the case these individuals hold or control, directly or indirectly, more than 25% of the capital stock or have preponderance in the corporate resolutions.

The absence of the information required by the NI until the deadline required may imply on the following sanctions: (i) the companies' CNPJ will be suspended, with the communication to CVM in respect to the foreign entities which have financial investments in the financial and capital markets and (ii) it will not be possible to carry out any transaction with the local banks.

Besides this theme, since January 2017 is being applicable the Law 13,259, which have established a progressive capital gain taxation method (rates may vary from 15% to 22.5%) that reached Brazilian individuals tax residents and non-Brazilian tax residents investing in Brazil outside the Brazilian financial and capital markets.

### 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?

Brazil is engaged in the OECD discussions, but few references have been formally made regarding BEPS in Brazilian tax legislation – e.g. a formal indication of compliance with Action 5 in the reasoning for the issuance of Normative Instructions 1,634 (and subsequent amendments) regarding the disclosure of the beneficial owner, as already mentioned on the topic mentioned above.

Besides that, in accordance with Action 13, Brazil signed on October 2016 the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports ("CbC MCAA") and on 28 December 2016, RFB published Normative Instruction 1,681 to implement annual country-by-country ("CbC") reporting in Brazil as of the tax year of 2016.

In respect the BEPS Action 6, until April 2017, there is no known implementation measure yet. Regarding the BEPS Action 15 Brazil participated in the ad hoc Group for the development of the multilateral instrument, but the expected timing for its implementation is not known yet.

## GENERAL

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

**A) Share deal**

**Tax advantages:** Tax losses and other tax attributes of the target company may be carried over. Minimisation of tax impacts in comparison with an asset deal, especially for Brazilian indirect taxes (IPI, ICMS, PIS, COFINS and ITBI purposes). Depending on how the transaction is structured, the buyer may be able to obtain a better tax result by acquiring the relevant shares, instead of acquiring directly the assets. The benefit is that acquiring shares could allow for the recovery of the purchase goodwill (part of acquisition price exceeding net worth and fair value of target's assets) through tax deduction of such goodwill for Corporate Income Taxes basis. There is no need to transfer or terminate employment relationships in course, which avoid the labor and tax costs of termination of employment contracts.

**Tax disadvantages:** Pre-acquisition tax, legal and labor liabilities of the target remains with the purchased legal entity. In principle, the acquisition of part of the target's business is not allowed. Pre-acquisition structuring steps may take some time to be implemented.

**B) Asset deal**

**Tax advantages:** The buyer usually obtains a step-up on the book value of the assets. If the acquired assets constitute a going concern / establishment, the buyer may obtain certain benefits of tax credits and certain other tax attributes, especially those associated with indirect taxes, such as IPI and ICMS. It often helps to minimise the risk of tax, legal and labor liabilities. It may take less time to implement.

**Tax disadvantages:** Tends to result in a more tax burdensome transaction when compared to a share deal (especially for Brazilian indirect taxes – IPI, ICMS, PIS, COFINS and ITBI purposes). It may prevent the buyer from acquiring the target's tax losses and other tax attributes. Depending on the assets or businesses acquired, acquiring assets may require new registrations for tax, labor and other regulatory purposes. In the case the assets transferred constitute a going concern / establishment, the risk of tax, legal and labor liabilities cannot be avoided.

## 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?

The rules of Purchase Price Allocation ("PPA") could step up the value of tangible and intangible assets of the acquired company. However, in some cases, Brazilian corporate income taxes could be levied on such increase of value.

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

Current tax legislation determines that the goodwill paid on local transactions (involving non-related parties) must be allocated according to IFRS rules: goodwill must be allocated first to the fair value of assets/liabilities and intangibles and the remaining portion could be allocated as deductible goodwill for tax purposes (based on future profitability). Tax amortization of the goodwill (excluded previous allocation on the fair value of assets/ liabilities and intangibles) was preserved, complying with the maximum limit of 1/60 per month. As a condition for

the tax deduction of the goodwill, a PPA report must be prepared by an independent expert and filed with the Brazilian Federal Revenue or the Register of Deeds and Documents within 13 months.

Goodwill tax deduction is still allowable, provided certain conditions are met, mainly that an independent report is prepared and filed with the tax authorities or the Register of Deeds and Documents and, especially, that the deal is not carried out between related parties.

## 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?

The Brazilian legislation establishes requirements for the deductibility of interest expenses arising from debt operations with related parties or lenders located in low-tax jurisdictions or under a privileged tax regime. Generally, for tax purposes, the debt cannot be higher than: (i) two times the amount of the participation of the related lender located anywhere outside Brazil (except for lenders located on low-tax jurisdictions or under a privileged tax regime) in the net equity of the borrower and (ii) 30 percent of the net equity of the borrower if the lender is located in a low-tax jurisdiction or under a privileged tax regime (whether it is a related party or not). This rule also applies for any kind of debt operation where a foreign related party acts as guarantor, co-signer or intervening party of the debt contract.

The legislation also defines specific requirements that taxpayers must meet to deduct payments to beneficiaries located in a low-tax jurisdiction or under a privileged tax regime. These requirements include identifying the beneficial owner and determining the operational capability of the foreign party to carry out the operation agreed with the Brazilian party. In addition, the Brazilian transfer pricing legislation sets forth certain limits regarding the deductibility of interest expenses arising from debt operations with related parties. Brazilian BEPS Action implementations are not known yet in this respect. The deductibility of interest expenses arising from debt operations with non-related parties is allowed once the transaction is carried out at normal market conditions and such expenses seen to be necessary for the business activities of the borrower.

It is important to point out that there are no special interest limitations in Brazilian legislation in order to the cases of acquisitions of shares and assets. However, the mentioned general limitations are applicable to debt transactions regarding acquisitions of shares and assets.

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

In most situations where the purchaser intends to push-down debt on acquisitions, the legal entity that acts as the borrower is a Brazilian vehicle or holding company. Following the purchase, this legal entity is merged into the acquired operational legal entity.

Other structures may involve (i) back-to-back loans on the same terms and conditions, or (ii) obtaining a new loan at the level of the acquired company so that it can pay off the original loan. These structures may be feasible if the entire capital stock of the legal entity is purchased. Other structures may also be feasible but them should be subject to a case by case analysis.

Brazilian BEPS Action implementations are not known yet in this respect.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Brazilian tax rules do not provide a specific tax treatment for private equity financed transactions. However, Brazilian legal entities have available a deductible instrument for remunerating shareholders for the capital invested in companies: interest on net equity, calculated by reference to the net equity accounts, considering the official Brazilian long-term interest rate. The upper limit on interest on net equity is determined as the higher of: (i) 50% of the net income for the year, before deduction of the interest on net equity and deduction of the

provision for corporate income tax, but after the deduction of the social contribution on net income, and (ii) 50% of retained earnings plus profit reserves. Besides treating these payments as a tax-deductible expense, Brazilian tax law also requires them to be taxed at source at 15%, even if the recipient is a nonresident.

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

In general, tax losses are kept by the acquired company, but the income tax regulation provides for some exceptions, including the following: (i) on a merger, the tax losses of the absorbed company cannot be used by the surviving entity and thus are essentially lost, (ii) in a spin-off, the tax losses of the target entity are lost in proportion to the net equity transferred; (iii) carried forward tax losses are forfeited if the company's ownership and main activity change between the tax period in which the losses are generated and the tax period in which they are used.

Income tax regulation provides that tax losses generated in a fiscal year can be carried forward indefinitely by the company. However, the use of tax losses carry forwards is limited to 30 percent of the taxable income generated during the year.

Further, non-operational tax losses carryforwards may only be used against non-operational taxable income. The 30 percent limitation applies here as well. A gain or loss from the sale of inventory generally is treated as ordinary or operational activity, while a gain or loss from the sale of the machinery and equipment, buildings, land and general intangibles is treated as a non-operational (capital) activity.

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

Tax compliance in Brazil is an important point to be considered in due diligence, since Brazilian companies are subject to many levels of taxation (federal, state and municipal) and are required to file several ancillary tax obligation (tax returns, accounting and tax electronic bookkeeping).

Tax authorities have five years counted from the taxable event to collect or question the payment of taxes, reason why a good and deep due diligence shall be done with regard to payment of taxes, in order to verify any possible materialised or non-materialised (i.e. potential) tax contingency involving all taxes regarding the last 5 years. In addition, corporate reorganizations with the sole purpose of tax efficiency can be questioned by tax authorities and may be considered fraudulent. In this sense, not only past corporate reorganisations shall be evaluated, but also it is important to consult specialists before implementing any corporate reorganisation on the target companies.

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

There is no Brazilian stamp, issue, registration or similar tax or duties payable by shareholders on transfer of shares. There is no Brazilian inheritance or gift tax applicable to the ownership, transfer or disposition of shares, except inheritance or gift tax imposed by Brazilian states on inheritances or gifts by individuals or entities domiciled in Brazil or abroad.

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

Please see the answer to question 5.

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

As a general rule, VAT is not levied on acquisition costs related to share deals. Assets deals could be taxed for VAT purposes in Brazil and the recovery of relevant VAT could occur, depending on the applicable legislation, facts and circumstances.

In Brazil, VAT has a very particular system when applied at federal or state level. Federal VAT, referred to as Excise Tax ("IPI"), is levied on manufactured products. IPI is payable at varying rates on nearly all sales and transfers of industrialised products. Normally, it is charged at an ad valorem rate according to the classification of the product based upon the Harmonised Tariff Schedule, with rates ranging from zero to a maximum of 330%.

State VAT ("ICMS") is levied on communication services, inter-state and inter-municipal transportation services and also the circulation of goods. ICMS inter-state transactions are subject to rates of 12%, 7% and 4%. Intra-state transactions are subject to an average rate of 18% on goods and 25% on communication services. In Brazil, establishments or business units are generally treated as independent taxable persons for VAT purposes. There are no such provisions for VAT grouping, whereas cross-border transactions performed with a Brazilian entity or a Brazilian branch of a foreign entity may be taxed, if the transaction is subject to VAT in Brazil. Value added tax (VAT) credits may be transferred where an establishment is acquired as a going concern/establishment.

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

Law 13,259/2016, establishes a new progressive capital gain taxation method that is into force since January 2017 (rates may vary from 15% to 22.5%) and reaches Brazilian individuals tax resident and non-Brazilian tax residents investing in Brazil outside the Brazilian financial and capital markets.

In this sense, RFB issued Normative Instruction ("NI") 1,455 establishing the acquirer shareholder (or its legal representative if the acquirer shareholder is a non-Brazilian tax resident) is the responsible party for withholding the income tax levied on the capital gain verified by the non-Brazilian tax residents upon the sale or disposal of the Brazilian assets (e.g. Brazilian legal entity's shares). Capital gain verified by non-Brazilian tax residents shareholders corresponds to the positive difference between (i) sale or disposal price and (ii) acquisition cost suitable.

There are some discussions if the capital gain amount must be calculated in Brazilian currency (which may lead to the taxation of any positive foreign exchange variation verified by the non-Brazilian tax residents' shareholders) or in foreign currency. Although the RFB consolidated its understanding in the sense that this capital gain amount must be calculated in Brazilian currency, there are possibilities to sustain at Brazilian judicial tax courts that the capital gain involving the non-Brazilian tax residents' shareholders must be calculated in foreign currency. This is an open subject in the Brazilian case law.

As a rule, the acquisition cost amount should be proved by the non-Brazilian tax residents through suitable and proper documentation.

Besides that, the Brazilian tax legislation provided two options to determine the acquisition cost amount for calculating non-Brazilian tax residents' capital gain taxation in situations where there was no suitable and proper documentation: (i) based on the amount of foreign capital registered with Brazilian Central Bank ("BACEN") or (ii) the acquisition cost equals to zero. As of October 2016 the NI 1,662 has eliminated the first option to determinate the acquisition cost amount. This change has given rise to the need for non-Brazilian tax residents to obtain and keep proper and suitable documentation in order to support the acquisition cost for calculating the capital gain on the sale or disposal of the Brazilian assets (e.g. Brazilian legal entity's shares).

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

Depending of applicable legislation, facts and circumstances, it is possible to carry out a tax neutral environment through mergers based on book values. Brazil does not admit any consolidation for tax purposes and does not have a tax group.

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

Considering that the target companies' main activities involve the purchase and sale of real estate properties, besides regulatory and other tax matters, the main issues refer to the levy of Municipal Real Estate Transfer Tax (ITBI). The ITBI is a municipal tax payable by the buyer on the acquisition of real estate and the rate varies depending on the relevant Municipality. The basis calculation is the market value of the property or its appraised value, whichever is higher.

In addition, a presumed profit method for corporate income taxes could be interesting to decrease the tax burden of legal entities that deal with real estate transactions.

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

Brazil does not admit any consolidation for tax purposes.

In Brazil, establishments or business units are generally treated as independent taxable persons for VAT purposes. There are no such provisions for VAT grouping.

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

Differently from the patent box incentive, in which there is a lower rate of Corporation tax to profits earned from patented inventions and other innovations, the Brazilian tax legislation have established the "R&D tax incentive" by Law 11.196/05. This incentive is in the form of a volume-based R&D tax allowance, in which the rate varies between 60% (base) and 80%.

In other words, the Company which had expenses related with research and development of technology shall consider these expenses as deductible in the Corporate Income Tax Basis (CIT) in the proportion of 60% up to 80% depending on the circumstances enacted by the legislation mentioned above.

Considering the explained, the great value of the tax deduction of this incentive is directly linked with CIT rate (34%). In this sense, the effect of the R&D tax incentive shall be calculated according with the applicable percentage mentioned above (60%, 80%) limited to 34% of the CIT rate.

It is important to bear in mind that in case of insufficient tax liability, unused claims are neither refundable nor can be carried-forward.

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

Nowadays there is no specifically rule in Brazilian tax legislation that imposes a tax consequence if the ownership of intangible is transferred out of the country, besides an eventual challenge by tax authorities in relation to the purpose of the transaction.

Said this, in line with OECD rules and the Actions Plans in the context of BEPS, Brazilian tax authorities may challenge the transactions between a Brazilian company and the foreign party with the sole purpose of dissimulating the occurrence of a specific taxable event and transactions that seek to transfer resources out of the country without a "business purpose".

Despite the fact that there is no defined concept for business purpose, Brazilian tax authorities shall challenge the transaction if there is no other ground different of the tax efficiency.

In this sense, as mentioned before, as Brazil is a signatory of BEPS, and had adopted certain minimum standards of the Project (as an example, CbC file report) and have requested an OECD member, there is expectation that the tax authorities focus on transactions with the services and intangible from now on.

Besides this, another point to bear in mind is that, the transactions involving transference of ownership from a Brazilian company to a foreign company are quite rare nowadays, due to there are not many Brazilian companies, which are not member of a multinational group, which has controlled companies abroad. And, on the other hand, if the Brazilian entity belongs to a multinational group, the ownership of the intangible is, usually, of the foreign headquarter.

## 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?

The amount of capital gain realised as a result of a direct sale of shares issued by a Brazilian company equals the excess of the amount realised on the sale of the shares over its acquisition cost. That is, when earned by a Brazilian legal entity, the capital gain is subject to corporate income tax at a combined rate of 34%. When earned by a Brazilian tax resident individual, the capital gain is subject to progressive rates ranging from 15% to 22,5%.

A non-Brazilian legal entity or tax resident individual who sells assets located in Brazil are subject to WHT at rates that may vary from 15% to 22,5%, or 25% if they are resident or domiciled in a tax heaven jurisdiction. As mentioned on the answer to question 14, the method for the determination of the acquisition cost basis of non-Brazilian legal entities or tax resident individuals is not completely clear and is subject to different interpretations.

Additionally, nowadays there are no special treatments predicted by Brazilian tax legislation, applicable for capital gains derived from an M&A context.

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

Brazilian legislation does not provide for any fiscal advantage if the proceeds from sales are reinvested in Brazil.

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

On 14 September 2016 was published in the Official Gazette the Normative Instruction RFB 1,658/2016 that has clarified that a holding company is deemed to have "substantial economic activity" when, in its residence country, it presents an operational capacity suitable to its purpose, evidenced, among other factors, by the existence of skilled employees in sufficient number and adequate facilities for management and effective decision-making relating to: (i) the development of activities aimed at obtaining income derived from its assets or and (ii) the management of the equity stake aimed at obtaining income arising from the distribution of dividends and capital gains.

As per Normative Instruction RFB 1,658/2016's provisions, in order to identify the existence of economic substance, RFB is focusing more on the activity carried out by the holding company (rather than its corporate format).

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

Mergers, spin-offs and transfer of assets are also not in any case subject to indirect taxes or value-added taxes and there is also no tax on net worth of companies or individuals. Such transactions will, however, be subject to certain fees payable to commercial registries, and notarial offices (real estate and documents).

As far as spin-offs are concerned, like in the case of mergers, tax losses of the spun-off company and merged company cannot be off-set by the successor company. In case of a partial spin-off the tax losses of the spun-off company could remain available for offset by the spun-off company in proportion to the equity that remains after the spin-off.

# MANAGEMENT INCENTIVES

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

Brazil does not have attractive instruments for management incentives. However, for managers who are employees of a Brazilian legal entity, there are some tax benefits regarding labor duties and tax and social security taxes regarding Profit Share Programs and Social Security Regime for Temporary Dislocation, once certain conditions and requirements are met by the legal entity.

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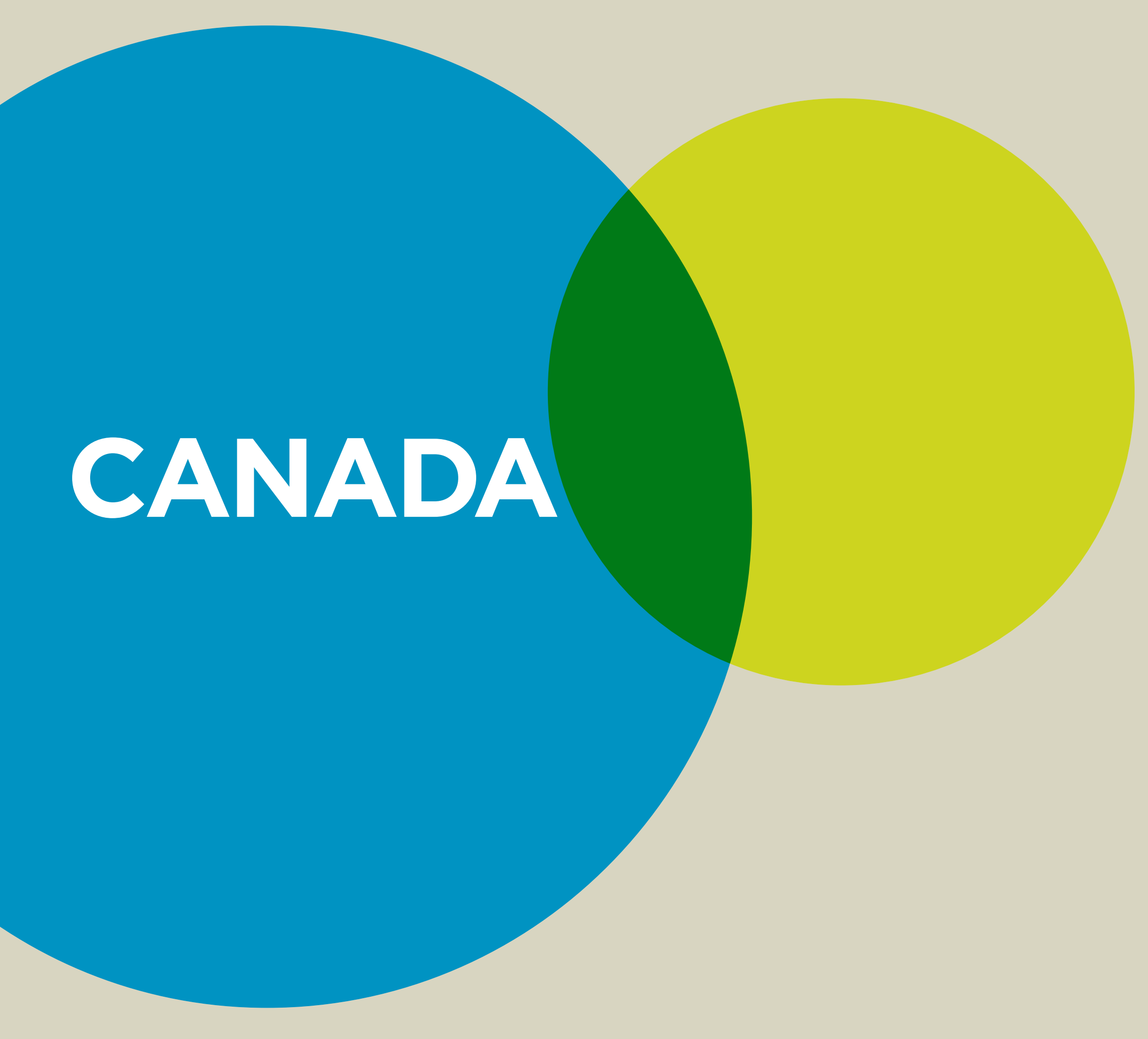
CANADA

# CANADA

## INTERNATIONAL DEVELOPMENTS

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

Legislative amendments in the past few years now strongly discourage a foreign acquirer of a Canadian corporation (Target) that itself has foreign subsidiaries from keeping those foreign subsidiaries "under" Canada. These rules effectively force the Canadian Target to sell or distribute its foreign subsidiaries "up" to the foreign acquirer. Canadian tax authorities perceive there as being generally no good reason to have a foreign-controlled Canadian corporation own foreign subsidiaries, largely because in some cases foreign multinationals have caused their Canadian subsidiaries to acquire the shares of foreign group members (so-called "foreign affiliate dumping") either in exchange for cash as a means of earnings stripping or in exchange for debt in order to use the result interest expense to erode the Canadian tax base

Over the past few years Canada has tightened its "thin capitalisation" rules limiting the extent to which interest expense owing to related non-residents may be deducted against Canadian-source income. See Answer 6, below.

Canada has also introduced various measures to protect its withholding tax regime on interest, royalties and similar payments.  In particular, new "back-to-back" rules apply where a Canadian pays such amounts to a recipient that itself has a connection to a non-resident who would, if it were the direct recipient of the payment, incur a greater Canadian withholding tax than the tax exigible on the payment to the actual recipient. These rules support the withholding tax applicable on interest payments to non-arm's length non-resident creditors. See "Canada Releases Revised Back-to-Back Loan Rules," Tax Notes International, October, 2014.  These rules were further expanded in 2016 to encompass royalties and comparable arrangements, and also constrain the creation of tax-deductible interest on acquisition financing and repatriation out of Canada by intra-group interest (see Answer 6). While not styled as such, they effectively constitute an anti-treaty shopping provision as regards withholding tax on interest and royalties.

### 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?

Canada signed the OECD multilateral Convention on 7 June 2017 (official Department of Finance release can be found here: https://www.fin.gc.ca/n17/17-054-eng.asp ). Roughly 75 of Canada's 93 bilateral tax treaties will be "covered tax agreements (the Canada-U.S. tax treaty will not). Essentially Canada has reserved on all of the provisions in the Multilateral Convention for now, other than the minimum standard provisions and the binding mandatory arbitration, in order to assess whether to adopt these provisions at a later date. Canada has begun the ratification process, which is anticipated to occur before the end of 2018.

**With reference to particular BEPS Action items:**

**BEPS Action 13:** Legislation to implement country-by-country reporting by large multinational enterprises has been enacted and is in force.

**BEPS Action 5:** Canada has begun spontaneously sharing tax rulings involving issues of potential BEPS concern with tax authorities in other countries. Canada Revenue Agency Information Circular 70-6R7 describes the types of tax rulings that Canada spontaneously shares with other countries.

**BEPS Action 14:** Canada is committed to improving the efficiency and effectiveness of MAP measures in its income tax treaties.

**BEPS Action 3:** The government believes that Canada's existing CFC regime is robust and meets the BEPS standard.

**BEPS Actions 8-10:** Canada is already applying revised international guidance in applying its domestic transfer pricing rules.

**BEPS Action 12:** Canada has existing rules requiring taxpayers, promoters and advisors to report specified tax avoidance transactions to Canadian tax authorities.

## GENERAL

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

**A) Share deal**

Sellers of shares will generally realise a capital gain in the amount by which their proceeds of disposition exceed the cost basis of their shares for tax purposes. This is generally advantageous as (1) only 50% of capital gains are included in taxable income, (2) capital gains may be offset by capital losses, and (3) some Canadian shareholders can claim an exemption up to a specified dollar amount on "qualified small business corporation shares." [1]

Non-resident sellers of shares will generally be subject to Canadian tax on a share sale only where (1) the shares have derived their value (directly or indirectly) primarily from Canadian real property and/or natural resource property at any time in the previous 5 years, and (2) no tax treaty relief is available. Where such shares are traded on a public stock exchange, a non-resident seller who (together with non-arm's-length persons) has not owned 25% or more of any class of the corporation's shares at any time in the 5 years preceding the sale will be exempt from Canadian capital gains tax. See "Canada's Section 116 System for Nonresident Vendors of Taxable Canadian Property", Tax Notes International, April 2012.

The buyer's cost basis in the shares of a Canadian corporation it acquires may in some cases be pushed down into the cost basis of land and shares owned by that corporation (see Answer 4 below). See "Tax Issues on Acquiring a Canadian Business," Tax Notes International, August 2015. Foreign buyers typically create a Canadian company to act as the direct purchaser of the acquired shares in order to access this step-up, as well as to maximise their ability to repatriate their Canadian investment as a return of "paid-up capital" that is not subject to Canadian dividend withholding tax.

**B) Asset deal**

Buyers often prefer to acquire assets rather than shares, as the cost basis of many assets can be deducted from income over time as a tax version of depreciation, whereas the cost basis in shares is generally of benefit only when those shares are sold. Asset transactions may generate sales tax, which is typically borne by the buyer. Canada has a federal multi-stage VAT in which buyers pay the tax (GST) and (if they operate a business) claim a full refund (input tax credit), which a number of provinces have harmonised their sales taxes with, to produce a harmonised sales tax (HST). Other provinces have non-harmonised sales taxes (PST) that can produce actual non-refundable sales taxes (see Answer 13 below). Most provinces have land transfer taxes.

Sellers generally prefer not to sell assets, because (1) sales of depreciable assets that have generated previous deductions from taxable income may produce a reversal of such previously-claimed deductions ("recapture"), and (2) the accrued gain/recapture that a corporation has on its assets is often much greater than the gain that its shareholders have on its shares. The separate tax category of property ("eligible capital property") that previously applied to most intangibles used or created in a business (e.g., goodwill, trademarks, etc.) was eliminated in 2016, and starting in 2017 such properties are now included in the same "depreciable property" regime that governs depreciation for tax purposes on tangible assets (see Answer 5).

[1] Expressed in very general terms, QSBC shares are shares of a Canadian-controlled private corporation (1) all or substantially all of the assets of which are used principally in an active business carried on in Canada, (2) which shares the seller has owned continuously during the preceding 24 months. The precise test is somewhat more detailed.

## 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?

Where one Canadian corporation (Buyer) acquires all of the shares of another Canadian corporation (Target), a cost basis step-up (or "bump") may be available when Target is merged up into Buyer and Buyer acquires all of Target's property (which merger occurs on a tax-deferred basis: see Answer 20). Foreign buyers often create a new Canadian corporation to act as Buyer in part for the purpose of availing itself of this cost basis step-up (an "88(1)(d) bump") where Target owns non-depreciable capital property with significant accrued gains (especially shares of foreign subsidiaries that need to be extracted out from under Canada post-closing, as per Answer 1). Effectively an 88(1)(d) bump is limited to Target's non-depreciable capital property: land, shares and (in some cases) interests in partnerships (this cost basis bump does not apply to goodwill). There are a number of technical constraints on this cost basis step-up, but it is a very valuable provision for foreign purchasers of Canadian corporations. See "Canada's 88(1)(d) Tax Cost Bump: A Guide for Foreign Purchasers" Tax Notes International, December, 2013.

Apart from an 88(1)(d) bump, cost basis increases in Target's property can be achieved in some cases through careful planning to apply any available Target tax attributes (e.g., loss carryforwards, accrued but unrealised losses, etc.) against accrued but unrealised gains on Target property. This kind of planning often requires co-operation from Target and in some cases taking steps before the purchase of Target is completed, since the acquisition of control of Target often reduces or constrains the use of Target's tax attributes following closing (see Answer 9).

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

In the 2016 federal budget, the Canadian government announced its intention to proceed with replacing the existing "eligible capital property" regime for amortizing goodwill and other business intangibles. Effective 2017, such property will be moved into the existing depreciable property regime that amortizes the cost of tangible capital property for tax purposes, with a 5% annual depreciation rate. See "Federal Budget 2016 — A Focus on the Middle Class and Continued Scrutiny of Corporate Tax Avoidance", March 2016.

### 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?

Interest on borrowed money is generally deductible to the extent used for the purpose of gaining or producing income, and to the extent that the amount paid is "reasonable" (i.e., not in excess of an arm's-length rate). Thus for example, borrowing to buy shares of a corporation, to buy assets to be used in a commercial activity, or to provide working capital for a business generally qualifies. Debt incurred for certain non-income-earning purposes (e.g., paying dividends, repurchasing shares of the debtor) is deductible by administrative practice within limits.

"Thin capitalisation" rules limit the extent to which interest owing to non-arm's-length non-residents may be deducted in computing income, in order to limit cross-border intra-group interest stripping. For example, a Canadian corporation is effectively limited to $1.50 of debt owing to such creditors for every $1 of equity: interest on debt in excess of such amount will be non-deductible (and treated as a dividend for withholding tax purposes). There are a number of subtle nuances in the computation of "debt" and "equity" for these purposes. The thin capitalisation rules are supported by anti-avoidance "back to back" loan rules directed at attempts to circumvent these rules (e.g., a loan from a foreign parent company to an arm's-length bank, made on condition that the bank in turn loan such funds to the foreign parent's Canadian subsidiary). There is no thin capitalisation constraint on debt owing to Canadian lenders or arm's-length foreign lenders, subject to the "back-to-back" anti-avoidance rules previously mentioned.

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

Since Canada does not levy interest withholding tax on debt owing to arm's-length creditors and such debt is not subject to "thin capitalisation" interest expense limitations, it is common to see a Canadian company that is created to effect the acquisition of a Canadian target borrow directly from arm's-length creditors (if necessary supported by a foreign parent guarantee). Alternatively, to the extent that such borrowing is done at the foreign parent level, the foreign parent can capitalise the Canadian acquisition company with a mix of equity and debt owing to the foreign parent within the 1.5:1 debt/equity limitations imposed by the "thin capitalisation" rules described in Answer 6. This will usually carry a withholding tax cost. Since 25% Canadian withholding tax applies on interest paid to a non-arm's-length foreign creditor, reduced to 10% for non-arm's-length creditors resident in most countries with which Canada has a tax treaty. The only Canadian tax treaty providing for a zero interest withholding tax rate on debt owing to non-arm's-length creditors is the Canada-U.S. tax treaty, if the U.S. creditor is entitled to benefits under that treaty (which has a limitation on benefits article).

Where the purchaser uses a Canadian corporation as the buyer of the Canadian Target, those two entities are typically merged (on a tax-deferred basis: see Answer 20) shortly after closing in order to consolidate in the merged entity any interest expense on acquisition debt incurred by the Canadian buyer with the operating income of the Canadian Target.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In addition to the discussion on the advantages of a share purchase in Answer 3, Canada also allows the amount used to purchase treasury shares of a corporation (i.e., the amount received by the issuer from the subscriber in exchange for issuing new shares), called "paid-up capital", to be returned to shareholders as a tax-free return of capital. There is no U.S.-style "earnings & profits" rule deeming corporate distributions to be dividends for tax purposes to the extent of E&P. Note that equity financing generally results in the creation of "paid-up capital" (the tax version of share capital), which constitutes "equity" for purposes of the "thin capitalisation" rule described in Answer 6. Canadian-resident shareholders can claim a lifetime exemption of about Cdn. $800,000 on capital gains from the disposition of "qualified small business corporation shares."

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

Target's capital losses (both realised and accrued but unrealised) do not survive the acquisition of control, making it important to undertake pre-closing planning in order to make the best possible use of these tax attributes. Accumulated operating losses from prior years (and the taxation year deemed to end on the acquisition of control) may be carried forward and used in post-closing taxation years only if (1) throughout the later year in which Target seeks to use the operating losses it continues to carry on the same business as gave rise to the loss (the loss business) with a reasonable expectation of profit; and (2) the post-acquisition income that the losses are used against arises from carrying on either the loss business or a business of selling similar property or providing similar services as were sold or rendered in the loss business. These rules prevent a buyer in, for example, the mining business from purchasing a company with losses generated in a completely different business (e.g., software development) and using those losses. Similar rules apply to various tax credits and resource-sector tax pools.

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

The following items should be included in the scope of a tax due diligence for Canada:

- Loans to a non-resident of Canada which remains outstanding for one year or longer
- Loans to a shareholder (or person with whom the shareholder does not deal at arm's length) which remains unpaid within one year after the end of the taxation year in which the loan was made
- Intercorporate dividends between Canadian corporations
- Fair market value and tax attributes associated with any Target subsidiaries (in particular non-Canadian ones)
- Quantum of Target tax attributes (e.g., loss carryforwards, accrued but unrealised losses) adversely affected by an acquisition of control
- Identify and estimate accrued gains on non-depreciable capital property eligible for 88(1)(d) bump described in Answer 4
- Determine whether Target shares are "taxable Canadian property" as described in Answer 16, if non-resident sellers exist

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

No.

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

In general, the deductibility of any such cost is subject to the general rule that such amounts be reasonable in the circumstances. In addition, such costs are also governed by the usual rules differentiating between (1) costs that are currently deductible and (2) those that are capital in nature and hence deductible only over time or capitalised in the cost basis of the property acquired.

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

There is a 5% VAT-style goods & services tax ("GST") in Canada. A number of Canada's provinces levy a corresponding "harmonised sales tax" ("HST", or in the province of Quebec "QST") that is applied alongside the federal GST at rates varying from province to province (e.g., 8% in Ontario). Provincial sales tax ("PST") is a single stage tax and is payable on taxable acquisitions and is not recoverable. Three of Canada's four western provinces (British Columbia, Saskatchewan and Manitoba) have a PST; the fourth (Alberta) has no provincial sales tax of any kind. All other Canadian provinces have an HST.

Where assets are acquired by purchaser that is registered for purposes of GST/HST/QST, and the purchaser is acquiring the assets for consumption, use or supply in taxable activities, any GST/HST/QST paid in respect of the assets or acquisition cost should be wholly or partially recoverable. The purchase of shares is exempt from GST/HST/QST; however, acquisition costs may apply and the acquirer may be entitled to a full or partial refund if certain conditions are met. The purchase of shares would not attract PST however legal services and other acquisition costs may be subject to PST which would not be recoverable.

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

Foreign buyers will typically make Canadian acquisitions through a Canadian acquisition company in order to

(1) create paid-up capital equal to the full amount of their equity investment (see Answers 3(a) and 8),

(2) merge that Canadian company with the Canadian Target to consolidate the interest expense on any Canadian acquisition debt incurred with the Target's operating income (see Answer 7), and

(3) obtain the 88(1)(d) cost-basis step-up described in Answer 4 (which is often especially important for foreign buyers). Foreign buyers are subject to greater constraints than are Canadian buyers on the use of the 88(1)(d) bump.

Where Target has foreign subsidiaries, planning will be needed to prevent adverse consequences from the "foreign affiliate dumping" rules described in Answer 1. The debt/equity mix of how Canadian operations are financed is also highly relevant (see Answer 6 regarding Canada's "thin capitalisation" constraints). Foreign buyers must also consider potential planning for repatriating assets from their Canadian acquisition (e.g., dividends, royalties, interest, management fees, etc.), as well as dealing with potential Canadian capital gains tax on an eventual sale of their investment. Transfer pricing rules will apply to transactions between the Canadian subsidiary and non-Canadian members of the foreign buyer group.

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

No group relief or consolidation system exists in the Canadian tax regime: each taxable entity pays tax separately. Canadian corporations can merge on a tax-deferred basis (see Answer 20), and in fact Canadian buyers of Canadian Targets typically merge post-closing in order to (1) consolidate their income and deductions and (2) claim the 88(1)(d) bump described in Answer 4. By using such tools and making the best use of available Target tax attributes (often in cooperative pre-closing transactions undertaken by Target prior to closing), opportunities for post-closing reorganisations without adverse tax results are maximised.

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

As described in Answer 3 above, non-residents may be subject to Canadian capital gains tax upon a sale where the shares of a company derive their value primarily from Canadian real property and/or natural resource property, in particular where no tax treaty relief is available to the non-resident. A number of Canadian tax treaties offer some degree of relief where the real property in question is used in an operating business, so careful planning can be very beneficial. A withholding regime applies to buyers of such "taxable Canadian property" from non-residents, which effectively requires buyers to withhold and remit to the Canada Revenue Agency (CRA) a portion of the sale price on account of the non-resident's potential Canadian capital gains tax liability, unless the non-resident obtains pre-clearance from the CRA that no such withholding is required. See "Canada's Section 116 System for Nonresident Vendors of Taxable Canadian Property", Tax Notes International, April 2012.

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

Fiscal unity/tax grouping is not allowed in Canada. As mentioned in Answer 15 above, each corporation in a corporate group is taxed separately.

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

No.

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

The disposition of the intangibles will trigger Canadian tax if the seller is a Canadian resident and the proceeds of disposition exceed the seller's tax basis in the disposed-of property.

# 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?

The taxation of capital gains for both residents and non-residents is described in Answer 3, above (see also Answer 16). No participation exemption per se exists, although the tools described in Answers 4 and 15 can often be used to reduce or eliminate accrued gains on Target property acquired (directly or indirectly) through an acquisition. Where Target has foreign subsidiaries, Canada generally will not tax dividends received from such foreign entities to the extent attributable to active business income earned in a country with which Canada has a tax treaty, and an election can be made to reduce capital gains on the shares of such foreign subsidiaries by the amount of such exempt dividends. This acts as a limited form of participation exemption on investments in foreign subsidiaries. [2]

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

There are no specific rules governing the reinvestment of proceeds from a sale of assets or shares, other than in very limited situations that are rarely encountered as a practical matter. It generally is possible to transfer property to a Canadian corporation in exchange for shares of that corporation on a tax-deferred basis.

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

No specific rules apply to holding companies. In all cases, Canadian tax authorities will wish to be satisfied that a holding/finance company (1) is in fact acting as a principal and not as an agent for another entity, and that it has the requisite capacity to do what it claims to be doing, (2) is in fact the beneficial owner of the property it purports to own (i.e., it has the indicia of ownership that the jurisprudence establishes as the hallmarks of beneficial ownership of property), and (3) is indeed fiscally resident where it claims to be (the location of the company's central management and control is often relevant in this regard). The back-to-back rules and pending anti-treaty shopping rules described in Answer 1 will make the use of holding companies in inbound planning more challenging going forward. Canada has a general anti-avoidance rule that allows transactions to be recharacterised in situations of abuse or misuse, and some Canadian tax treaties contain specific anti-avoidance rules.

[2] As noted above in Answer 3, capital gains are effectively taxed at half the rate at which ordinary income is taxed.

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

Two or more Canadian corporations can generally merge ("amalgamate") to form one Canadian corporation on a tax-deferred basis (for both the participating corporations and their shareholders), so long as the merged corporation acquires all of the property and inherits all of the liabilities of the participating corporations, and shareholders receive nothing in exchange for their shares of the participating corporations except shares of the merged corporation.

Conversely, de-mergers and spin-offs of Canadian corporations are possible on a tax-deferred basis only within a fairly narrow set of rules. As a very general statement, these rules allow a Canadian corporation holding multiple properties or businesses to restructure on a tax-deferred basis such that the same properties or businesses are held through two Canadian corporations rather than only one (i.e., some properties/businesses in one such corporation, and the remainder in the other corporation), so long as the existing shareholders maintain the same *pro rata* shareholdings of both corporations, the demerger is not part of a larger series of transactions including certain prohibited events (e.g., an acquisition of control of one company or the other), and certain limitations on the division of property between the two corporations are observed. Public company spin-outs, where a demerger occurs for the purpose of distributing shares of a subsidiary of the public company to its public shareholders, can be done within these constraints, but where the public corporation is not Canadian it is generally necessary that the spun-out company not derive more than 10% of its value from Canadian subsidiaries, i.e., Canada is a relatively *de minimus* portion of what is being distributed.

Outside of these demerger rules, there are no provisions in Canada that allow a Canadian corporation to distribute property to its shareholders on a tax deferred basis: a distribution of property by a Canadian corporation to shareholders will result in a deemed disposition of such property by the Canadian corporation, such that any accrued gains will be realised. This may or may not result in tax payable, depending on whether the corporation has offsetting shelter (e.g., loss carryforwards) available to absorb such gains. If the value of the distributed property is less than the paid-up capital of the shares on which such distribution is being made, it is generally possible for the distribution to be made to shareholders as a return of paid-up capital, which is not treated as a dividend and instead simply reduces the cost basis of the shareholders' shares of the distributing corporation. For more information see Spin-Outs in M&A: Bridging the Valuation Gap. Otherwise, the distribution will generally be treated as a dividend.

# MANAGEMENT INCENTIVES

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

The granting of a stock option by a Canadian corporation (the "Grantor") is not a taxable event for the recipient employee at that time (the "Grant Date"). The time at which the employee is taxed on the stock option depends on whether the Grantor is a Canadian-controlled private corporation ("CCPC"), a private Canadian corporation that is not controlled by any non-Canadian residents or public companies.

If the Grantor is not a CCPC, a taxable employment benefit is only recognised by the employee at that date on which the shares of the corporation have been acquired through the exercise of the options. The taxable employment benefit is equal to the difference between the fair market value of the shares acquired and the exercise price of the options. However, provided that the shares acquired are common shares and the strike price is not less than the fair market value of the shares at the Grant Date, the employee may claim a deduction of 50% of the ensuing taxable employment benefit employment.

Conversely, if the Grantor is a CCPC, the employee may further defer the recognition of the taxable employment benefit to the taxation year in which the employee disposes of the shares acquired through the exercise of the

options. If the employee of the CCPC holds the shares for at least two years before disposition, the employee may claim a 50% deduction of the ensuing taxable employment benefit employment, regardless of the strike price or whether the shares are common shares.

Generally, even though the recipient employee is taxed upon the exercise of the stock option (or sale of the shares acquired under a stock option in the case of a CCPC), the Grantor is not allowed a corresponding deduction. The taxation of stock options is discussed in further detail in "Tax Issues on Acquiring a Canadian Business," Tax Notes International, August 2015.

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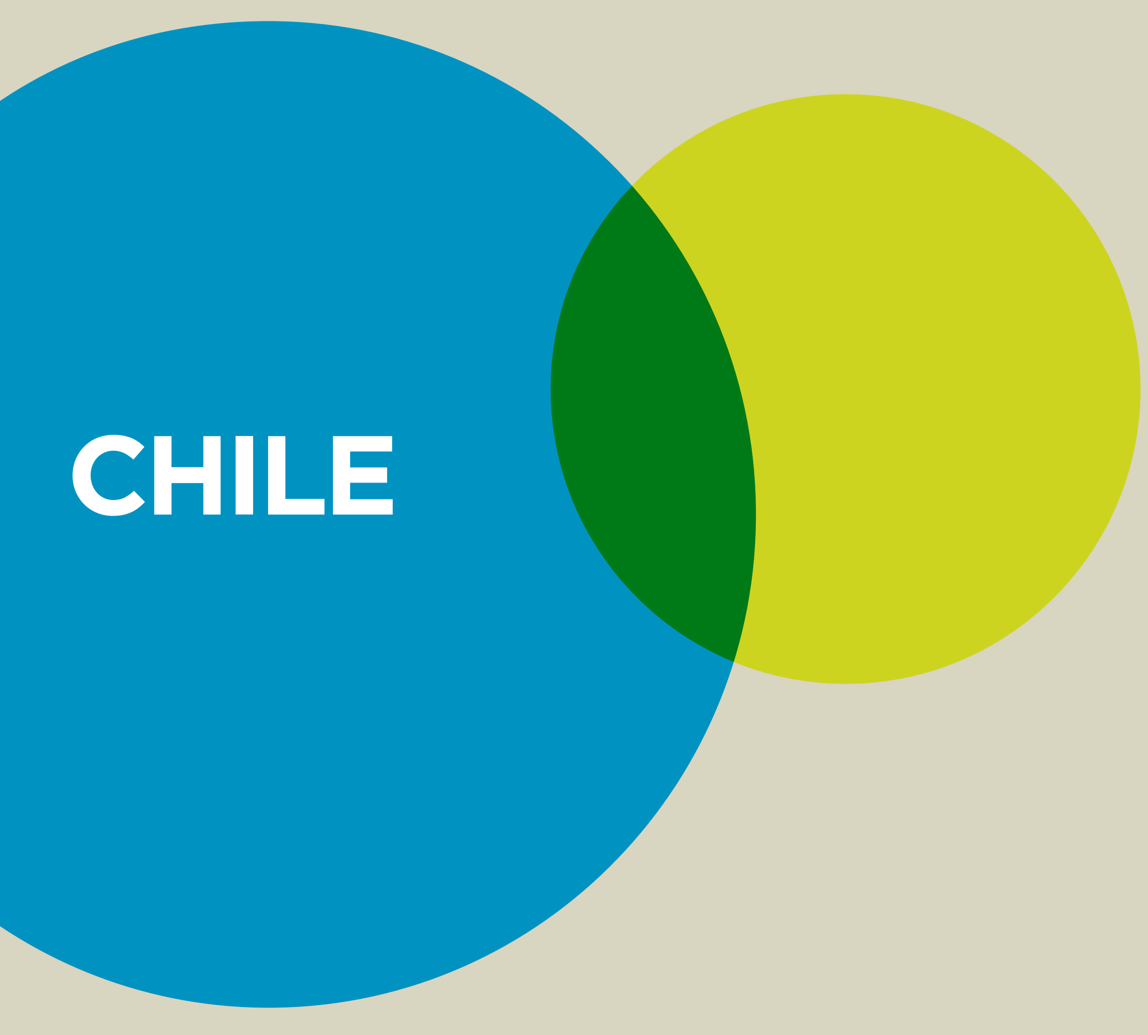
# CHILE



# CHILE

## INTERNATIONAL DEVELOPMENTS

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

The provisions of the 2014 Tax Reform enacted in Chile entered into force on 1 January 2017.

Although the reform included several legislative changes, the most relevant one was the introduction of two distinct tax regimes between which individuals and foreign companies must choose, one in which income is taxed on an accrual basis with a maximum tax rate of 35%, and one in which it is taxed on a cash basis with a maximum tax rate of 44.45%. However, foreign investors shall always be subject to the 35% rate if they reside in a country where there is a tax treaty in force or signed with Chile.

Among others important changes, Tax Reform also included: i) stricter rules regarding thin capitalisation; ii) carry-back of tax losses is no longer possible; iii) regarding mergers, the goodwill balance generated in excess of the assets' fair value can no longer be used as a deferred tax expense; iv) capital gains on sales of shares are taxed as ordinary income, whereas before the reform they were subject to Corporate Tax as a sole tax under certain circumstances; v) VAT now applies to the sale of real estate in many cases; vi) the endowment of the IRS with several new powers, including a new anti-avoidance rule and powers to access taxpayers' accounting records; vii) the introduction of Control Foreign Corporation Rules ("CFC") and viii) the modification of the Statute of Foreign Investment.

### 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?

Over the past few decades, Chile has continually had an open attitude regarding globalisation and has concluded several kinds of treaties with many different jurisdictions, regardless of the political parties that have held power.

In this sense, as an OECD member Chile has actively undertaken actions to implement BEPS standards. The two most recent tax reforms (2012 and 2014) have introduced rules dealing with the issues addressed by the BEPS Actions, even before the Actions themselves were issued.

Specifically, the 2012 tax reform included transfer pricing rules, which enable the Chilean IRS to challenge prices set forth in international transactions between related parties and also to conclude transfer pricing agreements with taxpayers. The transfer pricing rule placed the burden of proof on the taxpayer, as is set forth that it is the taxpayer's duty to demonstrate that transactions with related parties are carried out at fair value.

The 2014 Tax Reform further implemented BEPS Actions by introducing changes such as the following:

**i)** Stricter thin capitalisation rules which set forth a new way of calculating the borrowing company's equity for the purposes of determining its debt-to-equity ratio, considering all of its debts, instead of just the debt payable to related parties, as was applicable until then

**ii)** Controlled Foreign Corporation rules, which did not exist in Chile, and which make it mandatory for taxpayers to recognise as their own taxable income the profits accrued by controlled offshore entities

**iii)** IRS powers to require certain taxpayers to maintain digital accounting records, and even to access them at any time

**iv)** A new anti-tax avoidance rule that hinders taxpayers from using procedures that result in a lower tax burden and which are deemed to have no other significant purpose; and

**v)** Introduction of several rules that deter transactions with entities domiciled in territories considered tax havens, such as the inability to use foreign taxes as credit when intermediate entities domiciled in such territories are used.

Regarding Action 6 (prevention of tax treaty abuse), the tax treaties signed by Chile have consistently followed the OECD Model Tax Convention. The most recent tax conventions concluded by Chile, such as those concluded with Japan and Italy, have included provisions that prevent treaty abuse, by way of setting forth that a benefit derived from a treaty shall not apply if it is deemed that the main purpose of the creation of a structure or the conclusion of an agreement was to take advantage of such benefit. Also, during 2015 the IRS implemented a new affidavit which must be filled by all taxpayers included within a list of "sizable taxpayers", and which addresses BEPS-related issues, such as controlled offshore entities and operations with related parties.

Furthermore, Chile participated in the Ad Hoc group of jurisdictions in charge of developing the multilateral instrument set forth in BEPS Action 15.

Chile is also a signatory of the OECD Multilateral Competent Authority Agreement, and is scheduled to exchange information from September 2018.

Lastly, on 2009 a law was passed which considerably restricted the bank secrecy rule, enabling the IRS to request information from banks regarding tax audits in general; previously, this was possible only during investigations associated with tax felonies.

## GENERAL

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

**A) Share deal**

**Tax advantages:** From a seller's perspective, the tax cost of the shares can be deducted from their sale price, which can lead to a lower tax burden. In addition, the transfer of shares is easy and calculating their tax cost is simple.

Also, in the case of publicly listed companies, the sale of shares may qualify for a capital gains tax exemption if certain conditions are met.

From a buyer's perspective, the income generated by the acquired company is subject to corporate tax, but only

at the level of the company itself and not at the level of the buyer. Such income can be offset with future tax losses generated by the company.

**Tax disadvantages:** The target company's tax liabilities are always inherited. On the other hand, tax losses are not always available. The acquisition cost of the shares cannot be depreciated.

**B) Asset deal**

**Tax advantages:** From a buyer's perspective, the seller's tax liabilities (as well as other liabilities) are not inherited. Tangible assets acquired can be depreciated.

**Tax disadvantages:** From a seller's perspective, the depreciation of assets is deducted from their tax cost and, therefore, the capital gain obtained in the sale of assets (which is taxed as ordinary income) may be considerable.

From a buyer's perspective, tax losses are not available. In addition, income generated by certain assets (for example, land or certain financial instruments) will have a direct tax impact on the buyer. Also, in many cases the sale of fixed assets will be subject to Value Added Tax, which is not always recoverable by the buyer.

## 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?

As a general rule, in share deals it is not possible to step up the value of the target company's tangible and intangible assets. However, if the target company is absorbed by the holding company via acquisition of all of its issued shares, a merger can take place. In this case, goodwill rules apply, and if the acquisition cost of the target company's shares is greater than its tax equity, the difference can be allocated to the target company's nonmonetary assets, increasing their tax bases.

If the tax basis of the assets is increased artificially –such as by selling and then reacquiring the assets- the IRS could challenge the operation and pursue it as tax avoidance under the new anti-tax avoidance rule mentioned in number 1 above.

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

When a Chilean company is absorbed by another Chilean company, and the acquisition cost of the absorbed company's shares are greater than its tax equity, a goodwill balance is generated which can be used by the buyer of the shares to step up the tax cost of the absorbed company's nonmonetary assets, on a pro rata basis, up to an amount equal to such assets' fair value. If there are no nonmonetary assets, or if after allocating the entire amount of goodwill generated a balance still remains, such balance will be considered an intangible asset that can only be amortized when the company is dissolved or ceases to operate for tax purposes.

### 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?

As a general rule, interest payments on borrowings can always be deducted from income for tax purposes, unless the amount lent is used directly or indirectly to generate income which is tax exempt. If that is not the case, the law expressly states that interest payments on amounts borrowed in order to acquire a company's shares or other kinds of participation in a company will always be deductible from income.

However, under Chilean transfer pricing rules, the IRS may challenge the interest rate agreed upon if it is deemed not to meet arm's length conditions. Such limitations only exist when the borrower is a company domiciled or resident in Chile and the lender is a related party based abroad.

In such a case, interest can still be deducted from income; however, if the indebtedness of the Chilean debtor is greater than three times its equity, a 35% penalty tax is levied on interest payments made to related parties, which is to be paid by the Chilean debtor. In determining tax equity for these purposes, capital contributions which have been directly or indirectly financed by related parties are not considered.

It must also be noted that the 35% penalty tax only applies if the interest payments benefit from a reduced tax rate (lower than 35%), which may happen if i) the lender is a foreign financial entity, or ii) the lender is a resident of a tax treaty country (where it will usually benefit from a Withholding Tax rate of 10% or 15%).

The current rules were set forth by the most recent tax reform (2014), which changed the way of determining the borrower's tax equity.

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

A procedure commonly used to push down debt is to incorporate a Chilean entity into which both capital and debt is contributed. Such company may then acquire the target company, make a capital contribution to it or merge with it. If the acquisition is made under market conditions, there would be no tax issues to consider.

As said above, interest payments will be deductible for the borrowing company, but they will always be subject to thin capitalisation rules and transfer pricing rules if they are paid to a related party.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Currently there are no tax incentives of this kind in force in Chile.

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

The general rule is that tax losses incurred by the target company are available for the acquiring company.

However, they cannot be used in certain situations where it is deemed that the existence of tax losses was the main reason for the acquisition. Tax losses cease to be available when there is a change of control of 50% or more of the target company's shares, be it directly or indirectly, provided that: i) at the time of the acquisition, the target company lacked assets that were either sufficient to continue carrying out its activities or justify the acquisition price, or ii) the target company changes its scope of activities, without continuing its former business, within the 12-month period prior to or following the acquisition.

In the case of a merger or spin-off, tax losses can be used only by the company that originally incurred them.

Following a merger where a company absorbs another, the surviving company can still use its own tax losses, but not those of the absorbed company. If none of the companies survived the merger, tax losses cease to be available. The same applies for spin-offs: only the parent company that survives the spin-off can continue to use the tax losses it had incurred prior to the spin-off.

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

Income tax returns and accounting records for the last 6 fiscal years should be carefully examined, as that is the maximum statute of limitations applicable to taxes. Failure to file tax returns or late payment result in taxes being subject to a substantial interest rate of 18%; additionally, severe penalties are applied.

Regarding VAT returns, the maximum statute of limitations is 36 months. The Chilean IRS pays considerable attention to VAT, because it is the highest-grossing tax in Chile. The target company's activities and records should be examined taking this into account.

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

There is a stamp duty in Chile, but it only applies to the issue of certain debt instruments.

The transfer of shares, as well as the transfer of other kinds of assets, is not subject to any kind of transfer tax.

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

The costs incurred on the acquisition of a Chilean company are deductible provided that the taxpayer can demonstrate those costs to the tax authority.

In general terms, only direct costs may be deductible in determining the gross income of the taxpayer. In this sense, article 30 of the Chilean Income Tax Law provides that the direct cost of goods and services may be deducted. Regarding goods purchased in the country, the value or purchase price will be considered a direct cost, according to the respective invoice, contract or agreement; freight and insurance costs incurred until goods are delivered at the buyer's warehouses may also be included. On the other hand, regarding merchandise imported into the country, the CIF value, the admission rights, the customs clearance costs and, optionally, freight and insurance to the importer's warehouses will be considered as direct cost.

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

This depends on whether the acquisition was made by a VAT taxpayer. When an acquisition is subject to VAT and the buyer is a company that, in turn, makes sales which are subject to VAT, then the VAT paid by such company is not considered part of the acquisition cost, but rather as a VAT credit, which can be offset against the VAT debit due by the company. On the other hand, if the buyer is a company which is not subject to VAT (as will be the case in most share transfers), then the VAT paid by the acquiring company is considered part of the acquisition cost.

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

If a foreign company acquires a Chilean entity, it is important to consider the following matters:

**a)** Pursuant to the Chilean foreign exchange regulations, all inbound transfers of funds in relation to investments, deposits, loans, or capital must be made through the formal exchange market and must be notified to the Chilean Central Bank.

**b)** Under the current legislation, an "integrated" income tax system applies in Chile. Income tax is broken down in two parts:

i. A Corporate Income Tax ("CIT"), currently at a rate of 27% at the level of the local company, calculated annually on the net taxable income accrued.

ii. A withholding tax at a rate of 35% at the foreign owner level, payable upon profit distributions. CIT effectively paid for such profits may or may not be fully creditable against the referred WHT, depending on whether the owner resides in a treaty country. For this reason, for treaty country residents the effective income tax rate is 35%, but it can go as high as 44.45% for residents of other countries. This tax must be withheld, declared and paid by the local company within the first 12 days of the month following the distribution.

**c)** Also, article 10 of the Chilean Income Tax Law provides that the capital gain obtained from the sale of shares of a company incorporated or domiciled abroad by a non-Chilean resident (the "Foreign Seller"), may trigger Chilean income tax on such capital gain (the "Indirect Sales Income Tax"). This provision applies provided that the Foreign Entity owns, either directly or indirectly, the following underlying assets in Chile, as long as certain conditions are met:

i. Shares, equity rights, quotas or any other title that gives right to participation, control or profits on a company, fund or entity incorporated in Chile;

ii. A branch or other kind of permanent establishment in Chile of a non-Chilean domiciled person, for which purposes the permanent establishment shall be considered as a separate entity from its parent company; or

iii. Any movable or fixed property located in Chile, as well as any rights in connection therewith, whose owner or title holder is a non-Chilean domiciled or resident company or entity.

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

Yes, but only where the reorganisation is carried out and intended to qualify as a corporate restructuring pursuant to Chilean tax laws, and therefore aimed to modify the corporate structure of a corporate group without generating any tax effects in Chile, it is important to take into consideration that article 64 of the Chilean Tax Code provides as a general rule that the Chilean IRS is entitled to challenge the value agreed upon in any agreement that provides for the transfer of assets from one taxpayer to another, where such value is noticeably lower than the market price of the assets being transferred.

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

Under Chilean rules, in general there are no particular issues to take into account on the acquisition of companies that have significant real estate assets, other than the fact that such companies will often be subject to VAT, and therefore it must be examined whether the target company has complied with the applicable rules regarding VAT.

In addition, pursuant to several tax treaties entered into by Chile, the sale of a company which has significant real estate assets may not qualify for reduced WHT rates, as would be the case with other kinds of companies.

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

Fiscal unity/tax grouping is not allowed in Chile yet.

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

Chile does not have any special tax status such as a patent box for companies that hold intangible assets.

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

There are no negative tax consequences where the ownership of intangibles is transferred abroad.

# 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?

In order to answer this question, it is important to distinguish between taxpayers with no accounting records and taxpayers that determine their income using full accounting records.

**A. Taxpayers with no accounting**

Corporate Income Tax ("CIT") applicable to the sale of shares or capital rights was eliminated starting 2017, so the tax regimes that would affect the capital gain on the sale of shares or capital rights sales are the following:

**a)** CIT and Global Complementary Tax ("GCT"), in the case of Chilean resident individuals; or Withholding Tax ("WT"), in the case of taxpayers' resident abroad, on a cash or accrual basis, as chosen by the taxpayer.

**b)** Losses derived from other transactions of the same kind in the same year may be deducted.

**c)** Only accumulated attributable profits obtained by the entity being transferred are considered as part of the cost, not those attributed by third parties.

**d)** If profits do not exceed 10 "UTA" (Yearly Tax Units), the totality of the capital gain value is considered as a non-profit income and is therefore exempt from taxation.

**B. Taxpayers that determine their income in accordance with full accounting records**

**a)** Sole CIT no longer applies, so capital gains will always be considered income, on a cash or accrual basis.

**b)** Interests accrued from credits used to acquire shares or capital rights are tax deductible.

**c)** Only accumulated attributable profits obtained by the entity being transferred are considered as part of the cost, not those attributed by third parties.

*Capital gain taxation under Double Taxation Treaties (DTTs)*

Notwithstanding the rules explained above, if the seller is resident in a DTT country, reduced rates could apply.

Several DTTs in force set forth reduced WHT rates for capital gains obtained on the sale of shares and other rights representing the capital of a Chilean resident company to the extent that:

i. The seller has, at any time during the 12-month period preceding such sale, owned shares or other rights representing, directly or indirectly, less than 20% of the capital of that company; and

ii. The shares do not derive more than 50% of their value, directly or indirectly, from immovable property situated in Chile.

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

There are no fiscal advantages if the profits from the sale of shares are reinvested.

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

There are no special requirements for holding companies in Chile. However, companies that are under the holding entity can only choose the cash-basis tax regime, which provides for corporate tax being applied at a higher rate than the rate applicable to companies held directly by individuals (27% starting from 2018, as opposed to 25%).

Local resident shareholders and/or partners subject to Global Complementary Tax and non-residents subject to Withholding Tax (hereinafter referred to as "final taxpayers") will be subject to taxes on a cash basis, when profits are distributed or withdrawn from the entity. Final taxpayers will only be able to use 65% of the corporate tax paid by the source entity as a credit against their tax liability. As a consequence of the above, the overall tax burden may reach 44.45%. Therefore, as of today, under this system shareholders will still be able to defer taxation on Global Complementary Tax or Withholding Tax applied on profits generated by the source companies until these are distributed, but with the right to use a lower tax credit for the corporate tax paid.

Notwithstanding the aforesaid, final taxpayers who are domiciled in countries with which Chile has a DTT signed but not in force or in force will always be subject to an effective tax rate of 35%.

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

Generally speaking, mergers and spin-offs are neutral from a tax point of view in Chile. It is, however, important to note that, if the target company is merged into another, some of the target company's assets cannot be transferred to the surviving company. For example, the net operating losses may not be used if the target company is merged into the buyer company; the same applies to the VAT credit balance the target company may have. Therefore, in some cases it may be important to preserve the legal existence of the target company.

## MANAGEMENT INCENTIVES

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

As a general rule, a manager's remuneration is deemed as ordinary income and is therefore subject to payroll tax with a top marginal rate of 35%.

It is possible to implement a "sweet equity" plan, for example, by issuing preferred stock (such as shares entitled to preferred dividends) to members of management.

There is no tax issue in managers acquiring preferred shares at a discount value when a company first issues such shares. However, there would be a tax issue if other investors sold stock to managers at a discount price. In such a case, the IRS would be entitled to challenge the value agreed upon, as such a transaction would probably not be arm's length considering the company's net worth.

It is also possible to set forth a stock option plan in which managers or employees are given the right to acquire stock at a discount value. However, this kind of stock option is taxable as ordinary income and subject to payroll tax with a top marginal rate of 35%.

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# COLOMBIA

# COLOMBIA

## INTERNATIONAL DEVELOPMENTS

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

Recent tax reforms have recognized several corporate reorganizations as tax neutral transactions. Current tax rules recognize mergers, spin-offs and capital/in-kind contributions as tax neutral transactions. These new rules (introduced and developed since 2012) require certain conditions to be complied with for these reorganizations to be carried out in a tax neutral manner; among other things, tax neutral status depends on different business purpose criteria and corporate documentary.

On December, 2016 the Colombian Congress approved a tax reform (Law 1819 of 2016) that introduced several modifications that could affect M&A and private equity deals in Colombia (minimum price of shares for tax purposes, CFC rules, obligation to disclose the ultimate beneficial owner of local funds and companies, new GAR, etc.)

### 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 DIRECTIVE?

Colombia is in the process of being accepted within the OECD. The country is also part of the development of BEPS as a guest jurisdiction. As mentioned, a tax reform was enacted in 2016 (Law 1816 of 2016) which introduces certain rules that follow the BEPS actions, such as the CFC rules and exchange of information rules. This tax reform also improved the general anti abuse rule allowing it to have practical effects; however, Colombia has not adopted any measure to implement BEPS action plan 6 or 15.

## GENERAL

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

**A) Acquisition of shares**

Generally, the transfer of shares of Colombian companies generates Colombian source income for the seller. The capital gain generated on the transfer of shares is subject to capital gains tax in Colombia at a rate of 10%; provided, that the shares which are sold have been held for more than two years.

The recent tax reform establishes that in a share deal the purchase price should not be lower than the shares' equity value (book value) increased by 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed on the Colombian stock exchange.

The transfer of shares of a Colombian company as a consequence of a merger or a spin-off of the foreign holding company abroad is not subject to taxes in Colombia provided that the value of the assets located in Colombia, owned by the group of companies to which the companies participating in the merger or spin-off belongs, represents less than 20% of the total value of the assets of such group of companies. In a share deal the target company remains in existence and, therefore, the tax liabilities of the target remains with it after the closing of the transaction.

In addition, in a share deal the target company maintains its tax attributes such as net operating losses and tax credits without any modification or limitation due to the change in its control.

The acquisition of shares does not have immediate implications for the buyer. The tax basis of the shares is the purchase price and the tax basis of the assets of the target company remains the same and is not stepped up. Bear in mind that the difference between the book value of the target company and the purchase price paid for it (so-called goodwill or “crédito mercantil”) cannot be amortized for tax purposes.

The sale of shares of a Colombian company is not subject to VAT, stamp or registration tax. The sale of social quotas of limited liability companies is subject to registration tax at a rate of 0.7% on the transfer value.

**B) Asset deal**

Under Colombian tax law in an asset deal the pre-closing tax liabilities of the seller are not, as a general rule, assumed or transferred to the buyer of the assets.

An exception to this rule has been established in Bogotá in connection with the turnover tax (or industry and commerce tax) applicable in this city. In this case, the buyer of a commercial establishment or ongoing concern (“establecimiento de comercio”) is jointly and severally liable with the seller for the pre-closing industry and commerce tax liabilities of the seller (associated to industry and commerce tax associated to the activities of the commercial establishment).

In an asset deal, the purchase price paid by the buyer will be the tax basis of the acquired assets. In this manner, the tax basis of the assets is stepped up to their fair market value (at which the seller transferred the assets). This step-up would increase the depreciation or amortization deductions corresponding to the acquired assets.

Existing tax attributes of the seller, such as net operating losses do not carry over the buyer of the assets.

The sale of assets not excluded or exempted from the value added tax, are subject to this tax, generally at rate of 19 %. The sale of used fixed assets is not subject to VAT.

Additionally, if the buyer is an income tax withholding agent, it will have the obligation to apply a 2.5% withholding tax on the amount paid or accrued for the acquisition of the assets.

## 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?

Under Colombian legislation there are no rules that allow the stepping up of the value of the tangible and intangible assets of the target company in the case of share deals.

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

Under the tax reform introduced by means of Law 1819 of 2016 goodwill (“plusvalía” or “crédito mercantil”) cannot be amortized for tax purposes.

Notwithstanding this, there is a transitional regime for the outstanding balance of goodwill originated before the enactment of Law 1819 of 2016 that allows the amortization for tax purposes of such balance in a period of five years from 2017.

### 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?

As a general rule, interest paid on loans obtained for the acquisition of assets different from shares are deductible for income tax purposes.

Regarding interest paid on loans obtained in order to finance the acquisition of shares, it is important to take into account that under Colombian law costs and expenses related to non-taxed income or exempted income, are not deductible. In addition, in the case of the acquisition of shares by Colombian companies, as a general rule, the dividends that correspond to profit subject to income tax at the corporate level are considered for Colombian income tax purposes as non-taxed income of the Colombian company that acquired the shares. According to this provision, the Colombian Tax Office has stated that interest paid on loans obtained by Colombian companies for the acquisition of shares is not deductible if in the corresponding taxable year, the borrower has obtained non-taxed dividends. If during the corresponding taxable year, the borrower has obtained dividends subject to income tax (i.e., dividends that correspond to profits not taxed at the corporate level) or has not obtained dividends, the interest paid is deductible. Interest paid on loans obtained by individuals for the acquisition of shares are deductible as a general rule since the dividends received by individuals are subject to tax.

it is important to note that Law 1607 of 2012 introduced a thin-capitalization rule to the Colombian tax system. According to this rule interest generated by liabilities of which the total average amount during the year does not exceed an amount equal to 3 times the net worth of the taxpayer on 31 December of the previous year, are fully deductible for income tax purposes. On the contrary, the interests that exceed this limit must be treated as non-deductible expenses. This rule is applicable to foreign and local loans, and also to loans granted by related and by non-related parties.

Corporations, entities or special purpose vehicles incorporated with the purpose of building social interest housing projects and priority housing projects have the right to deduct the interests generated by liabilities of which the total average amount during the year does not exceed an amount equal to 4 times the net worth of the taxpayer on 31 December of the previous year.

The thin capitalization rules are not applicable to entities that are subject to the supervision of the Financial Superintendence and corporations, entities or special purpose vehicles that obtain financing to carry out public services infrastructure projects.

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

One of the strategies that is used to push-down debt on acquisitions is the use of a special purpose company for purposes of obtaining the loan to carry out the acquisition of a Colombian target company. After the acquisition, the special purpose company may be merged with the target company, where the target company is the surviving entity, in order to push-down the debt into the target company. This is relevant for the purposes of amortizing debt but it may not allow for the amortization of goodwill derived from the purchase of shares (the amortization of the goodwill is not deductible according to current rules as already mentioned in this document).

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no incentives for equity financing under Colombian tax law.

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

Generally, net operating losses of the target company can be offset against taxable income obtained by the target company in the following 12 taxable periods. Colombian tax law does not provide for a carry-back rule.

Companies resulting from mergers or spin-offs are allowed to offset net operating losses of the spun-off or merged companies up to an amount equivalent to the ratio of the equity of these entities within the equity of the company resulting from the merger or spin-off. This offset is only allowed if the economic activity of the entities involved in the merger or spin-off is the same before and after the operation.

## 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. The scope of a tax due diligence of Colombian companies (or assets) should include the usual issues covered in a tax due diligence process. Depending on the specific industry of the company, or on the specific nature of the asset, special rules should be observed.

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

Under Colombian law, there are no indirect taxes imposed on the transfer of shares. The transfer of shares is not subject to VAT or any other transfer tax.

Section 530 of the Tax Code establishes that the transfer of shares is exempted from the stamp tax. In any case, stamp tax is currently at a 0% rate.

As mentioned, the transfer of social quotas of limited liability companies is subject to registration tax at rate of 0.7%.

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

In general, costs and expenses can be deducted for income tax purposes as long as they are (i) directly related to the engaged activity, (ii) necessary, and (iii) proportional to the performed activities.

From 2014, the deduction of expenses and costs has been restricted in some cases. This rule has been introduced in order to promote the use of the banking system.

Cost related to the acquisition of shares is not deductible for income tax purposes (i.e., cost is the value of the asset for tax purposes and it is relevant at the time of an eventual sale).

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

Being a tax over added value, the VAT system allows taxpayers to credit input VAT against output VAT, provided that the former was levied on goods and services used in the production or manufacture of taxable goods and services. Additional restrictions may apply.

Note that there is no VAT on the sale of shares. VAT paid on expenses related to the acquisition of the shares is not deductible for VAT purposes.

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

Foreign companies can freely acquire participations in Colombian companies. The foreign exchange regime must be observed (i.e., registration of the investment in Colombia before the Central Bank) in order to repatriate dividends for instance. Foreign parent companies are subject to tax in Colombia only on their Colombian source income.

Dividends are considered Colombian source income. The foreign parent company will be subject to tax on dividends received from its Colombian subsidiary, if this local company distributes dividends out of profits not subject to tax in Colombia at corporate level, the dividends will be taxed at a rate of 35% plus a 5% withholding tax (this 5% withholding tax is applied after the deduction of the 35% withholding). If on the contrary, the Colombian company distributes dividends out of profits subject to tax in Colombia at corporate level, such dividends will be subject to 5% withholding tax.

Note that Law 1819 of 2016 introduced a tax on dividends that correspond to profits subject to income tax at the corporate level as abovementioned (5%) and it also modified the tax rate on dividends that correspond to profits not subject to tax at the corporate level (from 33% to 35%). These changes will apply to profits generated from 2017.

In general, DTTs in force with Colombia provide for withholding tax rates on dividends of 5% or lower. In general, these rates are not applicable to dividends paid out of non-axed profits which are subject to the 35% withholding tax.

## 15. CAN THE GROUP REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUPING?

Prior to 1 January 2013, all kinds of mergers and spin-offs were exempt from income tax, capital gain tax and value added tax in Colombia.

By virtue of Law 1607 of 2012 mergers and spin-offs between Colombian companies, or between Colombian and non-Colombian companies, and the transfer of goods located in Colombia as a result of off-shore mergers or spin-offs, will not be subject to income tax, capital gain tax nor value added tax, provided that certain requirements are met and subject to certain limitations.

Cross-border mergers or spin-offs where the absorbing or beneficiary company is non-Colombian will always be taxed.

Under Colombian commerce law, a merger occurs when two or more companies dissolve and, without liquidating, are absorbed by an existing company, or create a new company.

A spin-off occurs in the following two events: (i) when a company, without dissolving transfer one or more portions of its equity to one or more existing companies, or use them to create a new company, or (ii) when a company dissolves and, without liquidating divides its equity in 2 or more portions that are transferred to existing companies or are used to create new companies.

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

Notwithstanding rules under DTTs in force, under Colombian rules, there are no particular issues to consider in the case of an acquisition of shares of a company whose main assets are real estate.

In accordance with the general rule capital gains obtained from the transfer of shares of companies whose main assets are real estate are deemed to be Colombian source income and, therefore, are subject to taxes in Colombia.

It is necessary however to take into account the specific provisions of DTTs in connection with the capital gains obtained on a sale of shares of companies whose main assets are real estate. Currently, Colombia has entered into the following enforceable DTTs: Spain, Chile, Switzerland, Canada, Mexico, Portugal, South Korea, India and Czech Republic.

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

Under Colombian legislation, there are no fiscal unity/tax grouping rules.

## SELL-SIDE

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

Colombia does not have any special status (such as a patent box regime) for companies that hold intangible assets.

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

Note that in-kind contributions (applicable to assets in Colombia of any nature) to entities outside of Colombia are deemed to be taxable transfers for Colombian income tax purposes and subject to the general rules on transfer of assets (see section 20 below) and to the transfer pricing regime whether the involved parties are related entities or not. Under the tax reform introduced by Law 1819 of 2016, royalty payments between related parties on intangibles formed in Colombia are not deductible for tax purposes.

In addition, royalty payments related to the acquisition of finished goods are not tax deductible.

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

Under Colombian legislation, capital gains are taxed at a rate of 10%. In Colombia, there is no participation exemption regime.

**Share deals**

As a rule the transfer of shares of Colombian companies generates Colombian source income. The capital gain generated by the transfer of such shares is taxed in Colombia at a rate of 10%. This rule is applicable if the shares being transferred were held by the seller for two years or more, otherwise, the profit will be subject to income tax at a rate that could be up to 37% (year 2018) and 33% as of year 2019.

In a share deal the purchase price should not be lower than the shares' equity value increased in a 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed on the Colombian stock exchange. This will not apply if the transaction is subject to transfer pricing rules.

Any transfer of assets held by foreign non-resident entities in Colombia as a consequence of mergers or spin-offs is not subject to income tax in Colombia provided that the value of the assets located in Colombia, owned by the group of companies to which the companies participating in the merger or spin-off belong, is less than 20% of the total value of the assets held by such group of companies worldwide.

On the other hand the profits obtained from the sale of shares listed on the Colombian stock exchange will neither be subject to income tax nor to capital gains tax, provided that the sales do not exceed 10% of the outstanding shares of the respective company in a taxable year (Colombian Tax Code, Section 36-1).

Under the DTTs in force, in general, capital gains derived from the transfer of Colombian shares, are subject to tax in Colombia only if the shares is derive more than 50% of their value directly or indirectly from real estate located in Colombia. Some DTTs provide that the capital gain obtained from the transfer of Colombian shares is also subject to tax in Colombia if the seller has owned at any time during the 12 months prior to the sale, directly or indirectly, 25% or more of the capital of the Colombian company.

**Asset deals**

Gains derived from the transfer of fixed assets owned for more than two years are considered as capital gains (*"ganancias ocasionales"*) subject to capital gains tax at a rate of 10%. Gains obtained by a Colombian company derived from the transfer of fixed assets owned for less than two years are ordinary income subject to income tax at a rate of 37% (FY 2018) and 33% as of 2019 for foreign companies, and Colombian-resident taxpayers.

Losses derived from the transfer of fixed assets owned for more than two years are considered as occasional losses and can only be offset against capital gains (*"ganancias ocasionales"*). Capital gains can only be offset by occasional losses (*"pérdidas ocasionales"*). Therefore, the loss derived from the transfer of fixed assets owned for more than two years does not reduce the ordinary net taxable income of the taxpayer.

Transactions between local related parties are not subject to transfer pricing rules; however, the sale price cannot be lower than 75% of the fair market value of the assets being transferred. Transactions between related parties located in the Colombian territory and in Colombian free trade zones are subject to the transfer-pricing regime.

In the case of the sale of intangible property created by the seller (e.g. trademarks, patents, trade names, etc.) the tax cost basis for the seller, for income tax purposes is zero. Therefore, the entire purchase price is subject to income tax.

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

Currently, under Colombian legislation there are no fiscal advantages where the proceeds from the sale of assets are reinvested.

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

Currently, under Colombian legislation there are no substance requirements for holding/finance companies. Notwithstanding this, it should be noted that as from 2013, foreign companies may be deemed Colombian based companies for tax purposes if their effective place of management is located in Colombia. Substance criteria must be observed in these kinds of cases.

Please also note that Colombia's DTTs which are currently in force require that in order for an item of income to benefit from these DTTs, the entity/individual domiciled/resident in the other contracting state must be the beneficial owner of such income.

In addition, the 2016 tax reform introduced the CFC regime. Under this regime, any passive income obtained by the CFC must be attributed to the Colombian taxpayer in the fiscal year when it is accrued by the CFC, regardless of whether such entity has distributed or intended to distribute such passive income to the Colombian tax resident.

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

Under current tax law, mergers and spin-offs are non-recognition events. As such, they do not accrue income tax; value added tax or turnover tax. The requirement for this tax neutrality to apply is that no party involved in the reorganization (including the shareholders of the merged/spin-off entities) generate any sort of income or gain derived from such transaction.

Per the Colombian tax code, mergers and spin-offs will maintain their tax neutrality insofar as they meet certain requirements. Moreover, the shareholders of the companies involved will not have any taxable income derived from these processes provided that the requirements set-forth by law are met.

## MANAGEMENT INCENTIVES

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

The 2016 tax reform regulated the tax treatment of share-based payments and stock options, both for both companies and employees.

In the case of share-based payments, companies shall recognize the expense when it is accrued while employees shall recognize any income when the shares are delivered to them and they are registered as a shareholder.

The deductible expense for the company that delivers the shares is the fair market value of such shares which cannot be lower than the shares' equity value (book value) increased by 15%, in the case of shares not listed on a stock exchange. If the shares are listed on a stock exchange, the expense shall correspond to the value of the shares on the date of delivery of the shares. The income for the employee that receives the shares would be the same amount.

For the purposes of expense deductibility, companies must make social security contributions and operate withholding tax on labor payments.

On the other hand, in the case of stock options (employees acquire the right to exercise an option to buy shares) both the company's expense and the employee's income shall be recognized when the employee exercises the option.

The expense for the company shall correspond to the shares' equity value (book value) increased by 15% in the case of shares not listed on the stock exchange. If the shares are listed on a stock exchange the expense shall correspond to the value of the shares at the date of delivery of the shares. In these cases the employee has to recognize income in an amount equivalent to the difference between the price paid for the shares and the fair market value of the shares on the date on which the purchase option is exercised.

There are no specific rules related to management incentives in connection with selling or buying a company.

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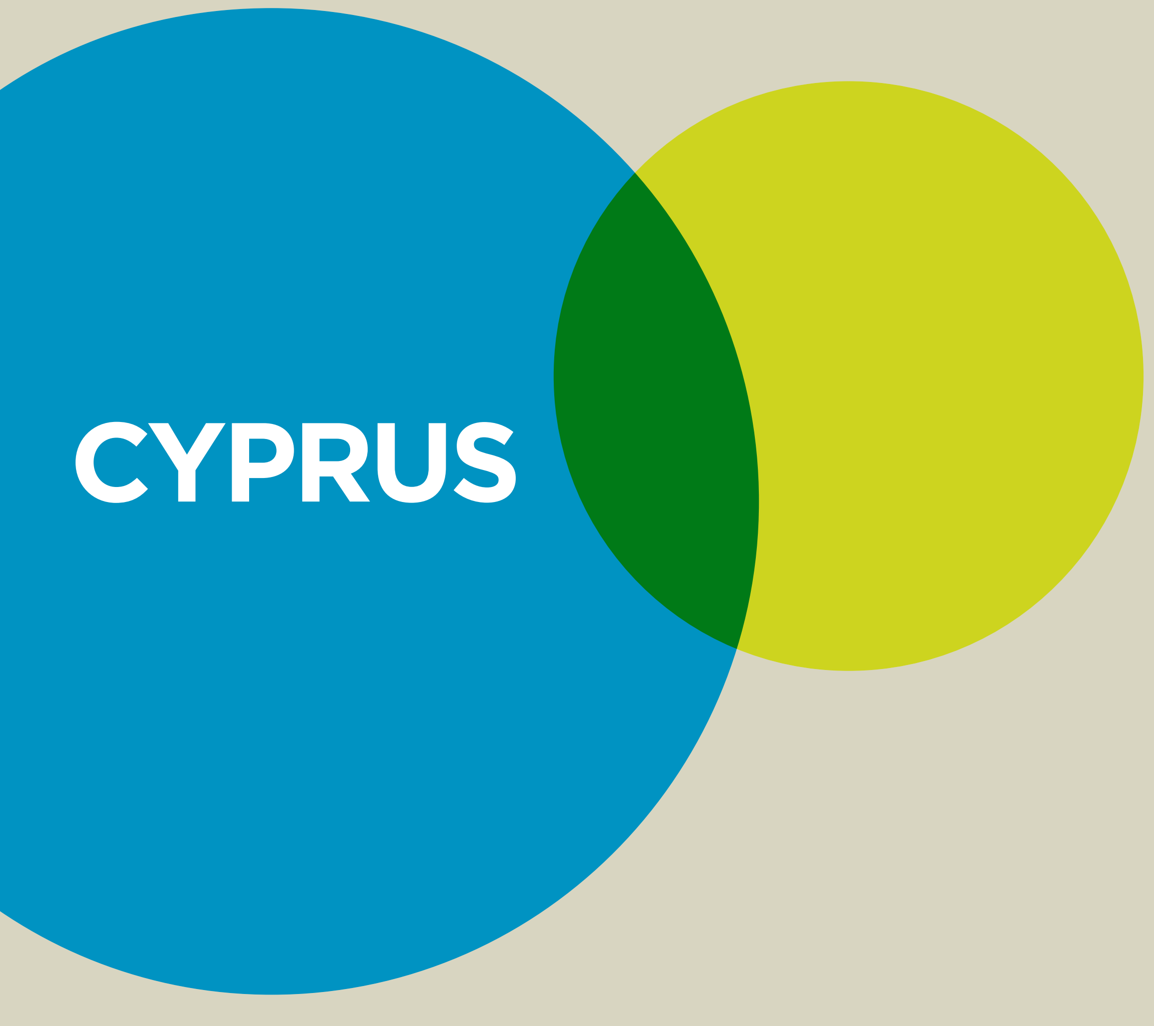

# CYPRUS

# CYPRUS

## 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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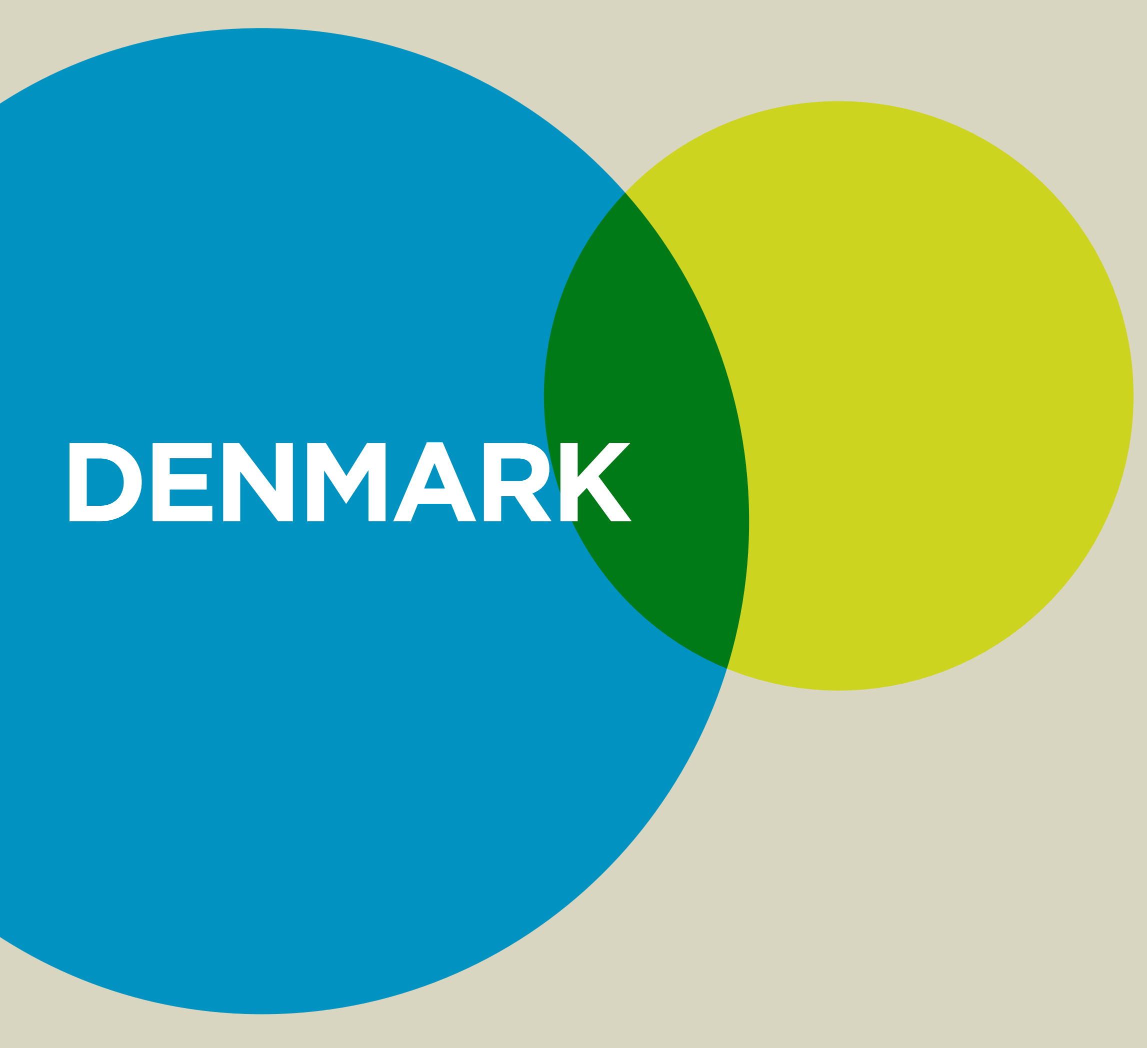

# DENMARK

# DENMARK

## INTERNATIONAL DEVELOPMENTS

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

On 19 December 2017 a new bill was adopted ensuring that companies can deduct payroll costs to employees working with the acquisition of enterprises. Prior to the bill only operating costs, i.e. payroll costs spent on obtaining, securing and maintaining income were deductible. With the bill the Government seeks to improve the circumstances for doing business by decreasing the administrative burden on enterprises caused by their not being able to deduct all payroll costs, but instead having to calculate in detail how much time the individual employees have spent on non-deductible activities must be dismissed. The new rule applies to payroll costs for employees and directors (both executive and non-executive) but not costs related to outside parties, e.g. accountants.

In March 2018 a new bill was introduced amending the rules regarding tax free cross-border mergers and divisions of Danish companies. With the bill the Government seeks to remove the current possibility to use an earlier date of merger or division than the date of the decision in the company(ies). The aim is to prevent taxable income being allocated from Denmark to another country by allowing mergers with retroactive effect. The amended rules will also apply to the transfer of assets. However, if the receiving company and the ceasing company both before and after the decision of the merger are subject to Danish international joint taxation the rules will not apply.

### 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 DIRECTIVE?

Denmark has implemented the OECD BEPS Action Point 6 and amendments to the EU Parent-Subsidiary Directive. The provision marks a change in the traditional Danish anti-abuse tax legislation doctrine which, in the past, targeted specific practices deemed to be abusive and, therefore, countered by specific anti-abuse rules (SAAR). The rule contains two provisions: An EU tax directive anti-abuse provision and a tax treaty anti-abuse provision. Despite differences in the wording, no specific difference in the contents is pursued between these two provisions. The EU tax directive anti-abuse provision mainly attempts to implement the anti-abuse or misuse amendment to the Parent-Subsidiary Directive and thus the Danish anti-abuse provision more or less mirrors the wording of the amended Directive.

Unlike the anti-abuse provision in the Parent-Subsidiary Directive, the Danish domestic provision is also intended to apply as an anti-abuse rule to all EU Direct Tax Directives, specifically the EU Merger Directive (2009/133) and the Interest-Royalty Directive (2003/49).

The tax treaty anti-abuse provision aims at implementing the expected outcome of the BEPS project, specifically Action Point 6. As the final report on Action 6 hadn't been released at the time of the adoption of the bill, it was arguably somewhat premature to introduce a provision incorporating the outcome of the project. Nevertheless, the bill aims at applying the provision on both existing and future Danish tax treaties based on the alleged general agreement among the OECD countries implying that states are not obliged to grant treaty benefits from participation in arrangements that entail abuse of treaty provisions. The provision states that treaty benefits will not be granted if: *"it is reasonable to establish, taking into account all relevant facts and circumstances, that obtaining the benefit is one of the most significant purposes of any arrangement or transaction which directly or indirectly leads to the benefit, unless it is established that granting the benefit under such circumstances would be in accordance with the content and purpose of the tax treaty provision in question."*

Since Denmark has not previously operated with a general anti-abuse provision, and due to the very general nature of its wording, a level of uncertainty around obtaining the tax directive or tax treaty benefits still exists. Uncertainty will at least exist pending on further specific administrative or court rulings regarding the use of both provisions. Accordingly, caution should be shown as to the application of such provisions, and specific tax advice thereon should be obtained.

Denmark has also implemented Action Point 13 of the BEPS Initiative (Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting). The OECD's recommendation of BEPS Action Point 13 has been directly implemented.

The country-by-country report must, for example, contain information relating to the global allocation of the multinational enterprise's income and taxes paid together with certain indicators of the location of financial activity within the multinational enterprise group and information on the multinational enterprise's total employment, capital, retained earnings and tangible assets in each tax jurisdiction. However, the Danish Ministry of Taxation has published a government order which more precisely describes the information that the country-by-country report must contain.

Regarding Action Point 15, the Government has announced that a bill will be introduced providing the domestic legal grounds for Denmark to sign the MLI agreement. Though the bill has not been introduced yet, it formed part of the legislative program of 2017/2018 and thus is expected in the near future.

The Anti-Tax Avoidance Directive is generally not expected to cause significant changes to taxation of Danish companies, as the majority of the initiatives are already established principles in Denmark.

## GENERAL

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

**A) Share deal**

The main difference between acquisitions made through share deals and acquisitions made through asset deals in Denmark is that no deduction is possible on share deals. Apart from the carry-forward of losses described below, the tax position of the acquired Danish company remains unchanged. Consequently, it is not possible to create a tax-free step-up in the tax basis of the assets of the acquired company. However, the capital gain realised by the seller on the sale of shares is often tax-exempt.

**Tax advantages:**

It is usually possible to carry-forward losses.

The capital gain realised by the seller on the sale of shares is often tax-exempt.

**Tax disadvantages:**

No deduction is possible on share deals.

**B) Asset deal**

In an asset deal, the purchaser will generally only inherit those liabilities that it assumes specifically pursuant to the terms of the asset purchase agreement. The purchase price must be allocated to the different assets included in the deal as the allocation serves as the basis for capital gains taxation of the seller and as the basis for the tax depreciation for the purchaser. The Danish tax authorities may challenge either the total cash value or the allocation between depreciable assets. Where no allocation is made, the tax authorities may assess an appropriate allocation and both the seller and the purchaser are obliged to apply the assessed values.

**Tax advantages:**

When acquiring assets, it is possible to depreciate the purchase price according to specific rules. A general prerequisite for depreciation is that the relevant asset is in fact subject to deterioration when in use. Land is not depreciable, for example. The method of declining balance depreciation is allowed for commercial operating equipment, i.e., machinery, vehicles, ships, aircraft, certain buildings, fixtures, furniture and other equipment used exclusively for business purposes. The depreciation balance is the balance at the beginning of the year plus acquisitions made during the year and less the proceeds from assets sold during the year. The maximum permitted rate of depreciation is 15% to 25% (depending on the specific type of assets included in the depreciation balance), and taxpayers are free to apply a lower rate and a different rate each year.

Goodwill may generally be depreciated over seven years.

**Tax disadvantages:**

It is not possible to carry-forward losses.

## 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?

No step up is available if the transaction is carried out as a share transfer. This is often a disadvantage with share transfers compared with asset deals.

Normally, a purchaser would investigate whether the target company has tax capacity in the form of a loss carry-forward which may be used to offset any subsequent taxable gains realised by the acquired company on the assets in this company. This investigation is relevant to assess whether an asset deal is preferential to a share deal.

### 5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Goodwill may generally be amortised over seven years. Goodwill forming a part of the acquisition price for shares cannot be amortised.

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

The deduction of interest expenses is limited by the following three rules which apply simultaneously (in chronological order):

**1)** A limitation based on the debt-to-equity ratio: Thin capitalisation limitations with a debt-to equity ratio of 4:1 are in force. This limitation only applies if debt to companies within a group exceeds DKK 10 million.

**2)** A limitation based on the value of assets: Net financing expenses are limited to an amount corresponding to 2.9% of certain assets (the asset limitation). The rate of 2.9% is adjusted annually. The limitation percentage does not apply to net financing expenses up to DKK 21.3 million calculated on a group basis.

**3)** A limitation based on annual profits: Net financing expenses may not exceed 80% of earnings before interest and tax (the EBIT limitation). Net financing expenses below DKK 21.3 million (calculated on a group basis) will be deductible under the EBIT limitation rule, but may be reduced according to the thin capitalisation rules described above.

As Denmark is subject to the EU Anti Tax Avoidance Directive (ATAD) it is expected that the EBIT rule will be amended to align with the EBITDA rule in the ATAD. No bill to amend the rule has been proposed as of yet.

As set out in the directive, there is a transition period until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard regarding BEPS Action 4. However, this period will end by 1 January 2024 at the latest.

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

Acquisition of a Danish corporation is often structured to reduce the tax base of the Danish target company by interest expenses incurred on the acquisition debt or by virtue of other deductible expenses.

This is achieved through the establishment of a Danish acquisition vehicle which partly debt finances the acquisition of the Danish target. Through the formation of a Danish (mandatory) tax consolidation group comprising the Danish target company and the Danish acquisition vehicle, the interest expenses on the acquisition debt and other deductible expenses can, subject to restrictions on deductions of interest and the utilisation of tax losses, be utilised to reduce the tax liability of the Danish target company.

The abovementioned rules regarding the limitation of deduction of interest expenses apply.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no incentives for using equity financing in Denmark, apart from avoiding thin capitalisation where by foreign debt outweighs the equity at a 4:1 ratio.

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

In Denmark, companies are granted an unlimited carry forward of tax losses. No carry back exists. However, the annual amount of losses from previous tax years to be set off against profits cannot exceed DKK 8,205,000 (approximately €1,102,000). It should be noted that this base amount applies to group level, i.e., companies that are jointly taxed have a mutual base amount of DKK 8, 205,000 for the group as a whole.

If the loss carried forward exceeds DKK 8,205,000, the remainder of the loss may be set off against 60% or less of the year's profit. There is no time limit for how many years the losses may be carried forward.

Loss carry forward restrictions exist in relation to control of ownership (more than 50%) of a company.

The main Danish loss limitation rule applies when more than 50% of the shares (or voting rights) in a company are transferred within one tax year. If this is the case, the net operating losses (NOLs) are limited to be offset against future operating income. Consequently, the NOLs may not be used to offset "net capital income", which includes net interest income, net income realised on the transfer of bonds and other debt instruments, dividends, net income realised on the transfer of shares and leasing income.

The loss limitation rules referred to above, if triggered, apply to the company's income in the year in which the transfer of more than 50% of its shares takes place. Thus, the loss limitation rules also apply to income realised before the transfer of shares in the company took place if such income is realised in the same taxable year in which the transfer takes place.

Additionally, a loss limitation rule applies to the transfer of more than 50% of the shares (or voting rights) in companies without any active trade or business.

Consequently, when more than 50% of the shares (or voting rights) in companies without any active trade or business are transferred, all of the NOLs are lost. A look-through rule applies to holding companies in that the activities of the subsidiaries are taken into consideration when determining whether the holding company has trade or business.

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

When performing a tax due diligence in Denmark, there are no specific items that must be included. However, it is important to note that the fine for not having prepared proper transfer pricing documentation is quite high. It is also important to note that the Danish Tax Authorities can make corrections in the company's taxable income regarding intra-group transactions until approximately five years after the transaction has taken place.

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

There is no indirect tax (such as stamp duty or transfer tax) on the transfer of shares in Denmark.

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

According to Section 8J of the Tax Assessment Act, expenses related to acquisition costs are, in general, not deductible if the acquisition is for the purpose of participation in management.

However, companies can deduct salaries of employees working on the acquisition of enterprises.

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

The Danish Tax Authorities will allow a company to deduct VAT in relation to the acquisition of assets if the acquiring company intends to supply services subject to VAT. As a main rule the Danish Tax Authorities will not allow a company to deduct VAT in relation to the acquisition of shares. However, following the decisions from the European Court of Justice in C-108/14 (Larentia + Minerva) and C-109/14 (Marenave), the Danish Tax Authorities will allow a company to deduct VAT in relation to the acquisition of shares in a subsidiary company if the acquiring company intends to supply services subject to VAT.

## 14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

The only particular issue to consider when acquiring a foreign company is whether a double taxation treaty is in place between Denmark and the other country.

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

After an acquisition, a group may reorganise in a tax-neutral environment. The decisive factor is whether 10% or more of the shares are owned or not. If so, there are a number of possible tax regimes. If this threshold is not met, the matter is more complicated. If these regimes are applied, no taxes will be triggered as a consequence of the event. Generally, the original acquisition values will be reflected in the values carried forward.

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

When acquiring a company whose main asset is real estate, a buyer must consider Denmark's complex rules on the depreciation of real estate. The sale of shares in a company whose assets are mainly composed of Danish real estate assets is subject to the same rules as the sale of other shares regarding corporate income tax (application of the participation exemption regime under the standard conditions) and transfer tax (absence of transfer tax).

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

In Denmark, joint taxation is obligatory for national groups. All Danish companies and Danish permanent establishments in a group must be included in the joint taxation calculation. Each group company prepares its own tax return, and then the results are consolidated for overall group taxation purposes. To determine which companies are in a group, the general rule is that a company is within the group if it is controlled by a group entity.

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

Denmark has no special tax status for companies that hold intangible assets.

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

If ownership of intangibles is transferred out of Denmark, and Denmark does not retain the right of taxation, the intangibles will be considered to have been sold for tax purposes. This entails that the gain on the intangibles, though not yet realised, will be taxed in Denmark.

The taxation can be postponed if the intangibles have been transferred to an EU Member State and that the company is still the owner of the intangibles. If postponement is possible and is opted for, the payment is made over seven years conditional upon the company paying 1/7 of the payable tax each year and provided the outstanding amount accrues interest at a rate of at least 3% per year.

# 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?

There is no taxation in Denmark of capital gains on shares realised when the seller is not a Danish tax resident entity.

If the seller is a Danish tax resident, entity capital gains are usually taxed at the regular corporate income tax rate of 22% for 2018.

Shareholdings are divided into three groups depending on the ownership percentage:

Tax exemption is granted for capital gains realised on the transfer of shares in companies where the shareholding constitutes at least 10% or more of the share capital (subsidiary investments). However, it is a condition that the subsidiary is a Danish subsidiary or a foreign subsidiary which is liable to tax in the state in which the subsidiary is resident and that the tax authorities in this state is obligated to exchange information with the Danish tax authorities according to a DTT or another relevant agreement.

If the shareholding constitutes less than 10% of the share capital and the shares are "unlisted shares" capital gains realised on the transfer of shares are tax exempted.

By contrast, if the shareholding constitutes less than 10% of the share capital and the shares are "listed shares" (shares that are listed on the stock exchange or similarly regulated markets) capital gains realised on the transfer of shares are subject to tax at the ordinary corporate rate of 22% for 2018.

**Losses on financial instruments**

The ring-fencing restrictions applicable to losses incurred on financial instruments, which contain a certain right or obligation to sell shares, now apply only to financial instruments relating to subsidiaries or group-related companies. Additionally, losses incurred on portfolio investments subject to the mark-to-market principle are deductible in other income.

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

There are no fiscal advantages when reinvesting the proceeds from a sale.

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

The Danish Tax Authority has taken the view that protection under the Parent-Subsidiary Directive and/or tax treaties is only available to the beneficial owner of dividends distributed. Accordingly, the distribution of dividend for Danish tax purposes will be tax exempt if the foreign recipient owns at least 10% of the company distributing the dividend, the above mentioned conditions regarding tax exemption for capital gains are met and the foreign recipient qualifies as the beneficial owner. However, if a foreign company does not qualify as the beneficial owner, the dividend distributed will be subject to a Danish requirement for withholding tax. Generally, the issue of beneficial ownership is determined on the basis of substance requirements. In general, a conduit company only acting as an intermediary receiving income on behalf of another company that de facto constitutes the recipient of the income in question will, from a Danish tax point of view, be disregarded in relation to protection under the relevant EU Directives and tax treaties. Such flow-through entity is not likely to be considered beneficial owner of dividends received and will, according to the Danish Tax Authorities, not be eligible for protection under the relevant EU Directives, meaning that the Danish standard rules prescribing the withholding of certain taxes will apply.

Denmark has adopted GAAR and will consequently disallow protection under the EU Parent-Subsidiary Directive if an arrangement or a series of arrangements have been put into place with the main purpose or one of the main purposes being to obtain tax advantages.

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

Denmark has fully implemented the merger directive.

# MANAGEMENT INCENTIVES

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

Companies are able to grant their employees employee shares (shares, RSUs, PSUs, purchase rights and subscription rights) at no cost or at a favourable price without the employees having to pay income tax on the value at the grant date. Instead, the employees become liable to pay tax when they sell their shares, at which point any legalised gains will be taxed as equity income (maximum 42%).

According to the provision in Tax Assessment Act section 7P (in Danish "Ligningsloven"), a number of criteria must be met in order for the rules on employee share schemes to be applicable:

**(i)** the employee and the employer company must agree on the granting of shares being subject to s. 7P;

**(ii)** the value of the granted shares may not exceed 10% of the employee's annual salary;

**(iii)** the shares must be granted by the employing company or a consolidated company as part of an employment relationship, for which reason board members cannot qualify as eligible grantees;

**(iv)** shares granted under employee share schemes must not make up a special class of shares;

**(v)** purchase and subscription rights may not be assigned to any third party.

The company is at liberty to decide whether the shares should be granted to all of its employees or only to certain employees.

The cost relating to the benefits of a qualifying section 7P scheme are non-deductible for the employer. However, costs relating to the implementation etc. of the scheme are deductible for the employer company.

If the company wants the costs relating to the scheme to be deductible they can use the provision in The Law of Assessment section 28 instead. According to this provision the employee is taxed of the value of shares at vesting (a total tax rate of up to 55.8%).

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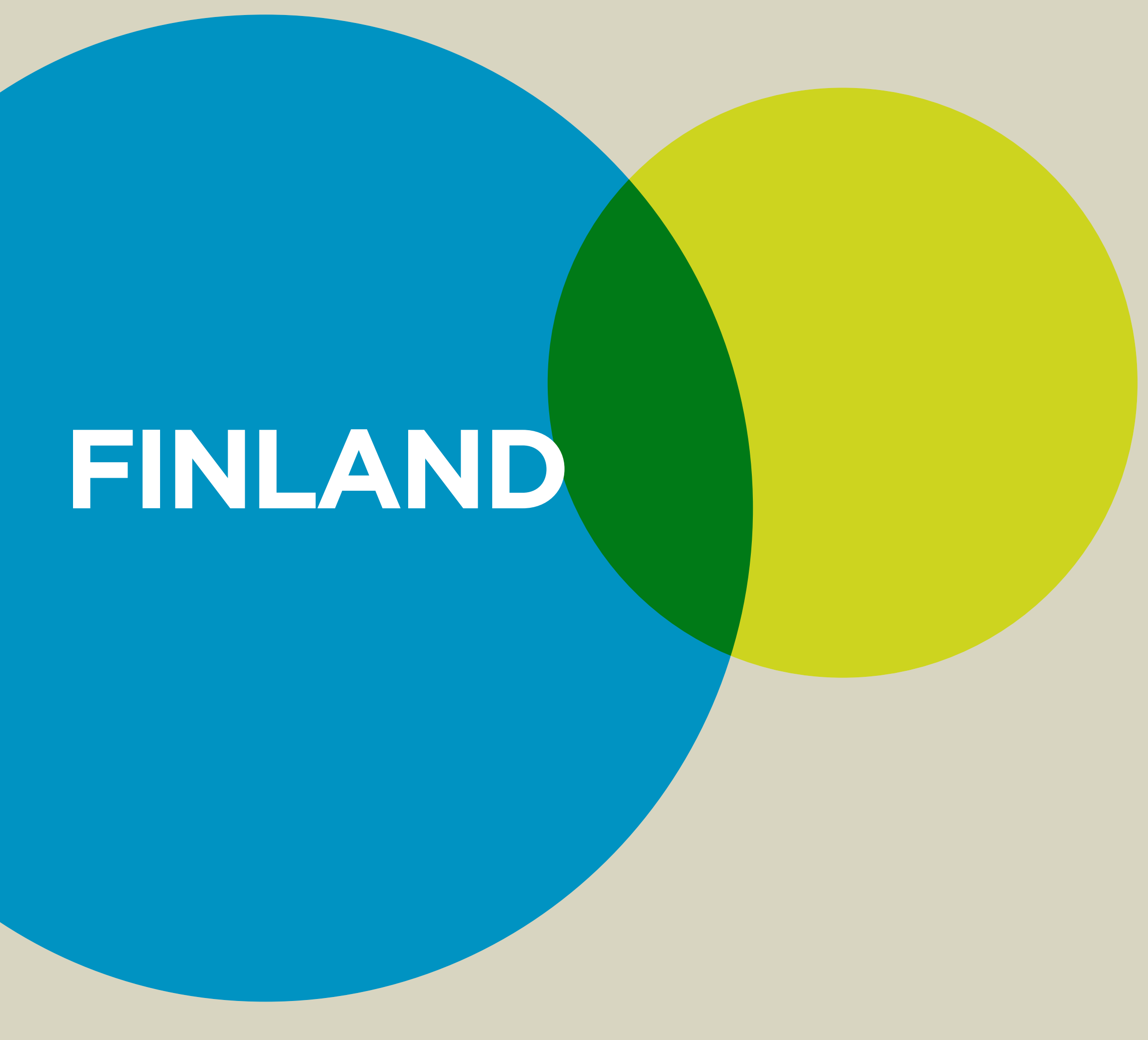

# FINLAND

# FINLAND

## 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 in Finland relate closely to the implementation of the Anti-Tax Avoidance Directive (ATAD) and planned reform of the corporate tax system as well as case law giving insight in interest deduction limitation and the application of the general anti-avoidance rule. During recent years, the Finnish Tax Administration has been aggressive in challenging existing structures and arrangements, which places taxpayers in a position to evaluate and document their actions prudently.

Current Finnish interest deduction limitations have been in force since 2014. Among other criteria, the applicability of limitations has been exempt, if the taxpayer could demonstrate that its equity over total assets is equal or higher than the equivalent group ratio based on the ultimate parent's statutory consolidated accounts. In recent case law, the statutory consolidated accounts of a group company owned by private equity funds has not been accepted as qualifying statutory consolidated accounts of the ultimate parent company, on which the equivalent group equity ratio could be based. The underlying reason was that the group company was considered as a sub-group parent company, which statutory consolidated accounts cannot be accepted as a basis for the group equity ratio.

The Finnish Ministry of Finance has published a draft government bill in order to implement ATAD's obligations on interest deduction limitation. However, in order to implement ATAD's obligations on interest deduction limitation, the Finnish Ministry of Finance has published a draft government bill. Although the general approach of the suggested implementation would be in line with the minimum standards set forth in ATAD, the suggested implementation would restrict in force even further intra-group debt financing. Moreover, the proposed measures would cover third party loans and the equity ratio based test could be abolished.

The Finnish peculiarity, division of corporates' income sources, would be abolished by extending the applicability of the Finnish Business Income Tax Act (BITA) generally to all corporations. As the Finnish Ministry of Finance has proposed in its draft government bill, a corporate entity's tax deductibles could be offset against all taxable income within one single source of income. Moreover, prior net operating losses would be simplified and intra-group loss relief would be available for all companies taxed in accordance with the BITA. For Finnish REC's and holding companies, intra-group loss relief through group contribution would be available, which has not usually been the case. Other entities, such as foundations and partnerships, could still have separate sources of income, although real estate activities could be classified as business activities under the proposed tax system.

In the private equity field the tax treatment of carried interest income has been subject to intense public discussion. In tax practice, the Finnish Tax Administration has classified carried interest income as earned income, but the Supreme Administrative Court in its case law has held in force an Administrative Court ruling in favour of taxpayers stating that carried interest was treated as capital income instead of earned income. Moreover, recent case law has reduced the attractiveness of payment-in-kind ("PIK") loans provided by private individuals. In private equity deals, preference shares have replaced partnership loans.

From the VAT perspective, a recent precedent from the Finnish Supreme Administrative Court confirmed that the seller may deduct VAT incurred on the sale of shares when the sale is done in connection to closing down a part of the business. The implications of this ruling are still somewhat unclear. Previously the Tax Authority has had an extremely restrictive approach to VAT deduction rights on costs relating to sale of shares or real estate.

## 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?

Finland has been active in putting the BEPS actions into practice. There are already enacted interest deductibility limitations and CFC regulation. Country-by-country reporting rules have been applicable to accounting periods ending in 2017 onwards.

Finland signed the multilateral instrument in June 2017 opting only for the minimum standards and making reservations to other articles. However, the required national parliamentary approval of the adoption is still pending. When in effect, this means that existing provisions, concerning for example permanent establishments, will remain unchanged in covered tax treaties. Tax treaties not covered by the multilateral instrument are the Nordic Income Tax Treaty and the Bulgarian Income Tax Treaty.

With respect to BEPS action 6, there is no expressed intention to take action other than to implement related minimum standards in the multilateral instrument. By adopting the Principal Purpose Test it is intended that Finland would fulfil the minimum standard of Article 7. Finland does not adopt the additional provision granting the competent authority the right to grant the treaty benefits even though the Principal Purpose Test provision applies.

Based on the notification, Finland would adopt the other minimum standards in the following way:

- **Article 6 – Purpose of a Covered Tax Agreement:** Finland would amend the preamble describing the purpose of the tax treaty so that, in addition to the elimination of double taxation, it is expressly stated that the intention is not to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Finland would not amend the preamble indicating the desire to develop economic relations and extend cooperation in tax matters.
- **Article 16 - Mutual Agreement Procedure:** Finland would adopt to its tax treaties the minimum standard by including paragraphs 1 to 3 in Article 25 of the OECD Model Tax Convention and the amendment concerning the taxpayer’s right to initiate a mutual agreement procedure in the source state in addition to their residence state. Finland would make a reservation according to which the updated Article on mutual agreement procedures would apply to tax periods subsequent to the entry into force of the multilateral instrument.
- **Article 17 - Corresponding Adjustments:** Finland would adopt the provision on corresponding adjustments to those tax treaties that do not currently include the provision.
- **Mandatory binding treaty arbitration:** Finland would apply the arbitration process of the multilateral treaty with certain reservations. Finland would opt for the “final offer” process in which an arbitration panel would select one of the competent authorities’ proposed resolutions as its decision. Arbitration would not be available if a decision on the issue has already been rendered in a domestic process.

The implemented rules based on the amendment of the Parent-Subsidiary Directive have been in effect since the beginning of 2016. The implemented rules cover a Limitation-on-Benefits (LOB) rule and a General Anti-Abuse Rule (GAAR).

In respect to interest deduction limitations, the Finnish Ministry of Finance has published a draft government bill implementing ATAD’s obligations. Generally, the proposed implementation measures would impact interest deductions of associated taxpayers. In Finland the amended interest deduction limitation regime would become more stringent to its current state if the current version of the draft government bill is accepted. In accordance with the current proposal:

- Net interest costs to group companies and associated companies could be deducted up to €500,000 (the same as currently)
- Net interest costs to third party lenders could be deducted up to €3,000,000

- Net interest costs up to 25% of the taxpayer's earnings before interest, tax and depreciation (EBITD) would be tax deductible (the same as currently)
- Current equity ratio-based exemption could be abolished.
- The concept of interest would extend to e.g. financial leasing, derivative instruments, guarantee fees and bank arrangements fees.

The limitations will not apply to standalone companies. The draft government bill could still be subject to substantial changes before becoming a final government bill and enacted law.

## GENERAL

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

**A) Share deal**

**Tax disadvantages:** A share deal bears on two significant tax disadvantages. Firstly, the transfer tax of either 1.6% or 2.0% of the acquisition price is levied on the transfer of all but publicly traded shares in Finnish companies. If the value of the company is based on aspects other than the securities or real estate it owns, then the basis for transfer taxation can be significantly higher in comparison to an asset deal. The buyer is generally responsible for the payment of the transfer tax.

Secondly, the buyer cannot depreciate the acquisition cost of shares. The depreciation of the target company's assets may be continued within the company according to the depreciation plan applied by the seller, but goodwill paid on the shares cannot be depreciated.

In a share deal, previous losses of the target company may be lost (or retained) after a qualified change in ownership. Additionally, the buyer has to deal with all underlying tax risks relating to the purchased company even though, depending on the circumstances, the seller may be liable to reimburse additional taxes due.

A sale of shares is exempt from VAT. From the seller's point of view, a disadvantage is that the deduction of VAT incurred on transaction costs is denied as being considered to relate directly to the VAT exempt sale of shares and therefore the VAT cannot be deducted as overhead costs. However, according to a recent Finnish Supreme Administrative Court (SAC) ruling, a seller of shares was able to deduct the VAT on costs relating to a sale of shares as overhead costs when the sale was made in connection to closing down a part of the business. We expect that there will be more SAC rulings which will provide further clarity on circumstances where the VAT deduction can be made.

**Tax advantages:** Share deals are typically preferred by the sellers because under certain conditions the participation exemption may apply in which case the sale of the shares would be tax exempted.

Confirmed tax losses of the target company may under certain conditions be utilised against the target company's future profits despite of the change in the ownership. Additionally, in a share deal, a buyer may gain transfer tax savings, if assets of the target company comprise of real properties.

**B) Asset deal**

**Tax disadvantages:** A transfer tax of 1.6% for Finnish non-listed securities, 2.0% for housing or real estate companies and similar and 4.0% for Finnish directly-owned real estate is levied in cases where these assets are included in the acquired assets. With regard to real estate, transfer in a form of shares is therefore more advantageous than transferring the real estate directly. Another drawback is that tax losses may not be transferred in an asset deal.

From the sellers' perspective, asset deals may not be tax efficient because selling the assets may give rise to a taxable profit at the level of the target company, and repatriation of the profits to the shareholders may be subject to tax. Additionally, the seller has to deal with the remaining company and its potential tax liabilities.

**Tax advantages:** An asset deal is generally preferable from the buyer's perspective. The acquisition cost is allocated to the acquired assets often resulting in a step-up in the book values of the assets in question. The buyer may begin to make depreciations on these new values (in accordance with general depreciation rules). The purchase price may also be allocated to goodwill, which may also be depreciated.

An asset deal is out of scope of VAT when it fulfils the requirements set out in the VAT legislation. A case-by-case analysis is usually required to confirm the VAT treatment. According to the current tax practice, the transaction costs are generally considered over-head expenses of the seller, and therefore the VAT incurred on the costs is deductible in the proportion of the taxable activities of the seller. In comparison to a sale of shares, this is an advantage for the seller. However, according to a new ruling, a seller may deduct VAT on costs incurred on a sale of shares in certain circumstances. Therefore, depending on the circumstances, a seller might be able to deduct costs on a sale of shares as well.

From the seller's perspective, an asset deal may be a feasible option if the company has confirmed losses that can be utilised against taxable profit arising in the asset sale or if the conditions for a participation exemption are not fulfilled.

## 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?

No special legal provisions are in place to step up the value of the target company's underlying assets upon the acquisition of its shares. The acquisition cost of the shares is deductible from sales proceeds of the shares unless a participation exemption applies.

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

Goodwill (i.e. the difference between the target's book value and the purchase price paid for it that cannot be specifically allocated to other assets) is regarded as intangible assets that may not separately be disposed. The treatment of goodwill differs between an asset deal and a share deal.

In an asset deal, the purchase price for goodwill may be depreciated during its probable economic impact period (maximum ten tax years). The depreciated amount is equal for each tax year during its economic impact period. In a share deal, goodwill may not be amortised or depreciated for tax purposes, but the acquisition cost of shares is deductible in a subsequent transfer thereof unless the participation exemption applies.

### 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?

Deductibility of intra-group interest expenses is subject to limitations that are not limited to acquisition debt. Current limitations concerning the tax deductibility of interest payments have been applicable to corporations, partnerships, corresponding foreign entities and their permanent establishments as of the tax year 2014. The limitations are applied only if the interest expenses exceed the interest income received by the company.

A general safe haven of €500,000 is applied; if net interest expenses (including third party and related party interests) exceed €500,000 the interest limitation will nevertheless be applied to the entire amount. Interest may become non-deductible if such net interest expenses exceed 25% of the company's tax EBITD (taxable business

profits added with the aggregate amount of interest costs, depreciations and group contributions received; and deducted with the amount of group contributions granted).

Interest payments for third party loans are currently not subject to limitations. However, third party loans will be deemed as intra-group loans if a related party pledges a receivable to an unrelated party as security for the loan and the unrelated party provides a loan to another related party, or the loan from an unrelated party is de facto a back-to-back loan from a related party. Furthermore, interest expenses will remain fully deductible if the equity ratio of the company is equal to or higher than the consolidated equity ratio of the group.

In recent case law, the statutory consolidated accounts of a group company owned by private equity funds has not been accepted as qualifying statutory consolidated accounts of the ultimate parent company, on which the equivalent group equity ratio could be based. The underlying reason was that the group company was considered as a sub-group parent company, which statutory consolidated accounts cannot be accepted as a basis for the group equity ratio.

The regulation allows an indefinite carry forward of interest expenses that cannot be deducted based on the aforementioned restrictions.

Due to the national implementation of ATAD, the rules on interest deduction limitations will be subject to significant changes. Among other things, third party loans would be covered by the limitations. Moreover, as it is proposed in the draft government bill, the equity ratio test could be abolished. Interest deduction limitations would not cover standalone companies.

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

For most acquisitions the preferred strategy to push down debt is the use of a Finnish Special Purpose Vehicle (SPV), if a foreign buyer acquires a Finnish target company. The SPV is financed by loans from third parties or foreign group companies, often located in a jurisdiction with a low corporate income tax rate. As interest deductibility is and will be subject to limitations, feasibility of the debt structure has to be evaluated in detail.

Following the acquisition, the target's profits may be offset against the SPV's interest expenses under Finnish group contribution rules. As an alternative, the target may be merged with the SPV or liquidated, for example in order to consolidate operating profits and the interest expenses or acquisition loans.

According to Finnish group contribution rules, eligible contributions from an affiliated company are deducted from taxable profit of the contributing company and are added to the recipient company's taxable profit.

Same rules apply to a Finnish permanent establishment of a foreign head office that is tax resident in an EU Member State or in a state with which Finland has concluded a tax treaty containing an article of non-discrimination.

All these strategies have to be carefully analysed in order to avoid the application of Finnish anti-abuse pro-visions, as well as to comply with transfer pricing rules. The recent case law denying deductibility of interest expenses risen from share acquisition debts of a Finnish branch should not impact typical debt push-down strategies.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No special provision that would give tax incentives for equity funding is applicable.

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

Net operating losses incurred may be carried forward for the subsequent 10 tax years. However, the right to carry forward tax losses could be forfeited in certain cases.

The right to carry forward losses is forfeited, if more than 50% of shares in a company have been transferred during the loss year or thereafter. Also, if a corresponding change of ownership has taken place in a company owning at least 20% of the shares in the loss-making company, the losses are forfeited. The Finnish Tax Administration may upon application under certain conditions grant a special permission to offset losses.

However, for a listed company the right to carry forward losses is not forfeited unless more than half of the non-listed shares change hands (i.e. changes in the ownership of listed shares do not result in forfeiture of losses). Changes in ownership of listed shares do not affect losses of companies owned by listed companies either.

In case of a merger or demerger the transfer of losses is conditional, which has to be evaluated case by case.

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

The statute of limitation in direct taxation is three years in respect of tax years ending during 2017. Tax years that have ended in 2016 at the latest are covered by a five-year statute of limitation. The statute of limitation is calculated from the beginning of the calendar year following the tax assessment meaning that tax years are in principle open for reassessment for 4 (previously 6) years. If the decision was made before 1 January 2017, the statute of limitation is five years from the beginning of the calendar year following the tax assessment. In transfer pricing related and certain other matters, the statute of limitation of the Finnish Tax Administration is extended to six years. In certain criminal tax fraud cases, the statute of limitation could be extended up to 11 years.

From an income tax perspective, tax attributes such as tax losses and non-deductible interest expenses are of essence in the tax due diligence and should be observed in the structuring of the transaction. Additionally, the arm's length nature of the transactions between the shareholders and the target company and intra-group transactions should be covered in the review.

Transfer pricing issues in relation to intra-group financing transactions in the target company should be identified and analysed in a tax due diligence.

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

A transfer tax of 1.6% of the acquisition price is levied on the transfer of shares and other securities in Finnish companies. For real estate and housing companies, the transfer tax is 2%. As a main rule, transfer tax is not applicable to trade of shares in publicly listed companies. Additionally, transfer of shares between parties not tax resident in Finland are exempted from Finnish transfer tax unless the target is directly or indirectly a Finnish real estate or housing company. The purchaser is liable to pay the transfer tax. In addition to the acquisition price of the shares, the transfer tax base may include other payments benefiting the seller such as repayment of a target company's loan to the seller (by the buyer).

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

Costs arising directly from facilitating the acquisition, such as fees from legal and other professional services and transfer tax, are included in acquisition costs of shares. As such, the buyer may not depreciate the acquisition cost of the shares. Acquisition cost of shares is deductible against sales proceeds of the shares unless the participation exemption is not applicable.

However, in recent case law the Supreme Administrative court ruled that fees from professional services in relation to reorganisation could be deducted as yearly expenses under certain conditions. According to the ruling, the fees shall not be included in the acquisition cost of the shares, if the professional services related to strategic business planning and the reorganisation of the group structure. Relevant grounds were that no new business

assets were acquired and that the reorganisation was executed in accordance with Cross-Border Merger Directive and national legal provisions.

Financing costs related to acquisition of shares are deducted as yearly expenses i.e. they are not included in the shares' acquisition costs. This means that costs relating to financing or refinancing of the target company should be deductible, although acquisition costs of the acquired shares are not subject to depreciations.

Due to the aforementioned divergent treatment, drawing the line between yearly expenses and acquisition costs may be of essence from a tax point of view. Especially with regard to shares to which participation exemption is applicable, the classification of costs as acquisition cost of shares may cause non-deductibility of costs.

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

Yes, VAT on acquisition costs can be recovered by the buyer in the proportion the company acquiring the shares or assets has VAT taxable activities such as supplies of taxable management services. In addition to the taxable activity, a certain level of substance is required from the holding company (namely, at least one employee). If the acquisition is made by a pure holding company that does not have any taxable activities and is only passively involved in the management of its subsidiaries, VAT cannot be deducted and remains as a final cost for the buyer. It should also be noted that only the company acquiring the shares or assets may deduct the VAT, as the transaction costs are considered to relate to the acquirer's activities (i.e. a deduction by another group company which didn't make the acquisition is not possible).

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

A company subject to only limited tax liability in Finland is taxed in Finland only for the Finnish source income unless the person has a permanent establishment in Finland. Capital gains derived from the sale of shares are not regarded as Finnish sources income under Finnish legislation, as long as the company's assets do not essentially consist of real estate property.

Dividend distributions made by a Finnish company to a foreign corporate recipient are generally subject to withholding tax at 20%. However, this rate may be reduced in situations such as the following:

- Situations covered by the Parent-Subsidiary Directive;
- Situations where a tax treaty provides for a lower withholding tax rate;
- With regard to dividends paid to other EEC Member States, where the dividend would be tax exempt in similar domestic relations, assuming an agreement concerning exchange of information (or the Directive 77/799/EEC) is applicable between the countries, and assuming that the dividend recipient does not have the possibility of full tax credit in its home country.

Since dividends are tax exempt in most domestic relations between limited companies, the exemption actually applies to dividends paid to most EU Member States even if the Parent-Subsidiary Directive is not applicable.

As for acquisitions of Finnish entities by foreign partnerships or acquisitions of stakes in Finnish partner-ships, the passive ownership could raise a permanent establishment issue. Therefore, such acquisition involving a partnership should be carefully analysed and structured.

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

As an EU Member State, Finland has harmonised its tax provisions for tax neutral corporate transactions in accordance with the Merger Directive. These rules apply to reorganisations involving entities in EU/EEC and to purely domestic transactions. Additionally, according to old case law, tax neutral reorganisation provisions should apply also to mergers involving parties residing in tax treaty states, if the merger meets conditions for a merger under the resident state's legislation. However, share exchanges where the receiving company has resided in a non-EU/EEC country have not been treated as tax neutral.

Tax neutral mergers, divisions and transfers of assets are commonly utilised as pre or post-acquisition measures. An exchange of shares is mostly used as a means of carrying out the acquisition itself. Tax neutrality of reorganisations in effect means that arrangements do not cause income tax implications either for companies participating in the arrangements or their shareholders. Tax neutrality is often subject to fulfilment of certain conditions, for example in mergers, divisions and exchanges of shares, there are restrictions on the amount of cash contributions.

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

A real estate company is not a specifically defined legal term in Finnish law even though it is commonly used in practice; real estate companies can be organised e.g. as ordinary limited liability companies, residential housing companies or mutual real estate companies (MRECs). MRECs are limited liability companies with purpose to own and manage at least one building or a part of a building. Its shares are attributable to certain parts of the property and based on their shareholding, shareholders are entitled to hold and control the respective parts of the real estate. Therefore, for example, rental income arising from the leasing of the real estate accrues directly to the shareholders. Typically, income received by MREC comprises of monthly charges that the shareholders pay to the mutual real estate company.

Regular real estate companies (RECs) operate just as any limited liability companies – i.e. there is no flow through of income to the shareholders and taxable profits are expected to be incurred on the REC level.

Currently residential housing companies, MRECs, RECs and other real estate companies are not subject to interest deduction limitations. However, due to the suggested national implementation of ATAD, all companies would be subject to interest deduction limitation unless the company is a standalone company.

Many of Finland's Double Taxation Agreements (DTAs) include a paragraph entitling Finland to tax income arising from a shareholding in a Finnish company which owns real estate in Finland and shareholders of which are entitled to use the real estate based on their shareholding. Typically, Finland's taxing right also covers capital gains derived from the disposal of shares in real estate companies the assets of which mainly comprise of directly or indirectly owned real property located in Finland. However, there are also DTAs not allowing Finland to tax income or capital gains relating to such shares.

Capital gains derived by Finnish and foreign corporations (provided Finland is allowed to tax the capital gains) from the sale of RECs are subject to corporate income tax. Specific transfer tax provisions apply to sales of real estate companies.

From the VAT point of view, the taxability of the activities of the real estate company should be carefully analysed prior to the transaction to ensure the deductibility of VAT incurred on the transactions and operations going forward. VAT deduction may be limited because leasing activities are VAT exempt (with an option to VAT under certain circumstances).

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

Corporations are taxed separately under Finnish tax regime. However, the Finnish group contribution regime allows under certain conditions Finnish group companies and Finnish permanent establishments to offset their profits and losses. In practice, eligible contribution is deducted from taxable income of the contributing company, whereas the contribution is considered as taxable income of the receiving company.

Group contribution regime is available only if certain conditions are met, such as both the contributing and receiving companies are Finnish tax residents and that they carry on business activities. Additionally, there must be a sufficient direct or indirect group ownership between the participating companies. Moreover, it is required that the group relationship between participating companies has lasted for the entire tax year and that the participating companies' financial years ends at the same time.

If the proposed draft government bill on corporate tax reform would enter into force as such, group contribution would be available to all companies, which taxable income is calculated according to BITA. In practice, this would mean that holding companies and REC's would be eligible for group contribution irrespectively, if they carry on business activities.

In value added taxation, tax grouping is available for companies engaged in financial and insurance activities when the companies in question are closely bound to one another by financial economic and organisational links.

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

There is no special tax status for companies holding intangible assets.

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

No adverse tax consequences specifically relating to transfer of intangible assets are imposed.

# 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?

Under the participation exemption regime, capital gains derived by companies from the transfer of shares are not considered as taxable income, and consequently acquisition costs of shares are not tax-deductible if the following conditions are met:

- The transferor of the shares is a limited liability company, a co-operative, a savings bank or a mutual insurance company taxed in accordance with the Business Income Tax Act
- The transferor is not engaged in venture capital or private equity activities
- The shares belong to the transferor's fixed assets
- The transferor has owned at least 10% of the share capital of the target company without interruption for at least one year during a period that has ended no more than one year prior to the transfer
- The target company is not a residential housing company, a real estate company or a limited company the activities of which de facto mainly consist of real estate holding or managing

The target company is:

- A Finnish resident company
- A company referred to in Article 2 of the EU Parent-Subsidiary Directive
- A company resident in a country with which Finland has a tax treaty, which is applied to dividends distributed by that company

If participation exemption is not applicable, capital gains are subject to corporate income tax at the rate 20%. Capital losses accruing from the transfer of shares belonging to fixed assets, but not covered by the exemption, are deductible from taxable capital gains derived from transfers of fixed asset shares in the same tax year and the subsequent five tax years. This limitation is not applied to the transfer of shares in residential housing companies, real estate companies and real estate holding or management companies. If the company transferred is not resident in a tax treaty state, the capital loss is not deductible in the transferor's taxation.

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

There is no specific tax advantage provided for reinvesting the sale proceeds.

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

No substance requirements are in place for holding or finance companies tax resident in Finland. A company is resident in Finland based on being incorporated in Finland.

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

Under Finnish merger provisions mergers are tax neutral provided that in a merger one or more Finnish corporate entities or partnerships are dissolved without liquidation and all of the assets and liabilities of the dis-solved company are transferred to another Finnish corporate entity or partnership. The surviving company has to give its shares to the shareholders of the merging company and cash contribution may not exceed 10% of the share capital. The merger provisions apply to EU/EEA companies covered by the merger directive. Moreover, according To Finnish Case Law, the merger provisions also apply in some cases to non-EU/EEA companies residing in tax treaty states. Qualifying mergers do not cause any direct tax consequences to the companies or their shareholders and they are exempt from Finnish transfer tax and VAT.

Finland does not have any special provisions concerning spin-offs However, provisions concerning tax neutral divisions may apply. A qualifying division does not cause any direct income tax consequences, VAT and transfer tax consequences to the involved companies or their shareholders. Under certain conditions, the division provisions apply also to partial divisions. In a qualifying partial division, the transferred assets must form an independent business unit and at least one independent business unit must be left in the transferring company.

## MANAGEMENT INCENTIVES

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

Employment based incentives benefits are treated as earned income in Finland. Benefits arising from incentives for managing directors and members of the board are also considered as earned income even though there is no employment relationship between them and the company. According to Finnish case law, the aforementioned tax treatment cannot be avoided by providing the respective management services through a company.

The tax treatment of share based incentive schemes depends essentially on the nature and structure of the scheme. Employee stock options and other similar instruments through which management are entitled to subscribe an employer's or its group company's shares in preferential terms are subject to taxation as earned income. There could also be obligations to pay social insurance contributions depending on the nature of the scheme. For example, qualifying synthetic options are not subject to social insurance contributions. By exercising the option, the benefit is realised in taxation which in practice means that the difference between the price paid by the employee and the fair value at the moment of exercise is taxed as earned income of the exercise year.

Profit arising from the schemes in which management invests directly into the company at arm's length conditions and bear real risk to lose their investment should be treated as capital income. To ensure the treatment as capital income, the arm's length nature of the scheme should be prudently verified and investments should not be financed by the employer. In 2014, the Finnish Supreme Administrative Court issued a ruling concerning so called management's holding company structures. In the ruling, a structure where a holding company owned directly or indirectly by employees had acquired the employer's shares and the employer had partly financed the acquisition was considered to be set up with purpose to avoid taxes and therefore income arisen in such structure was classified as earned income.

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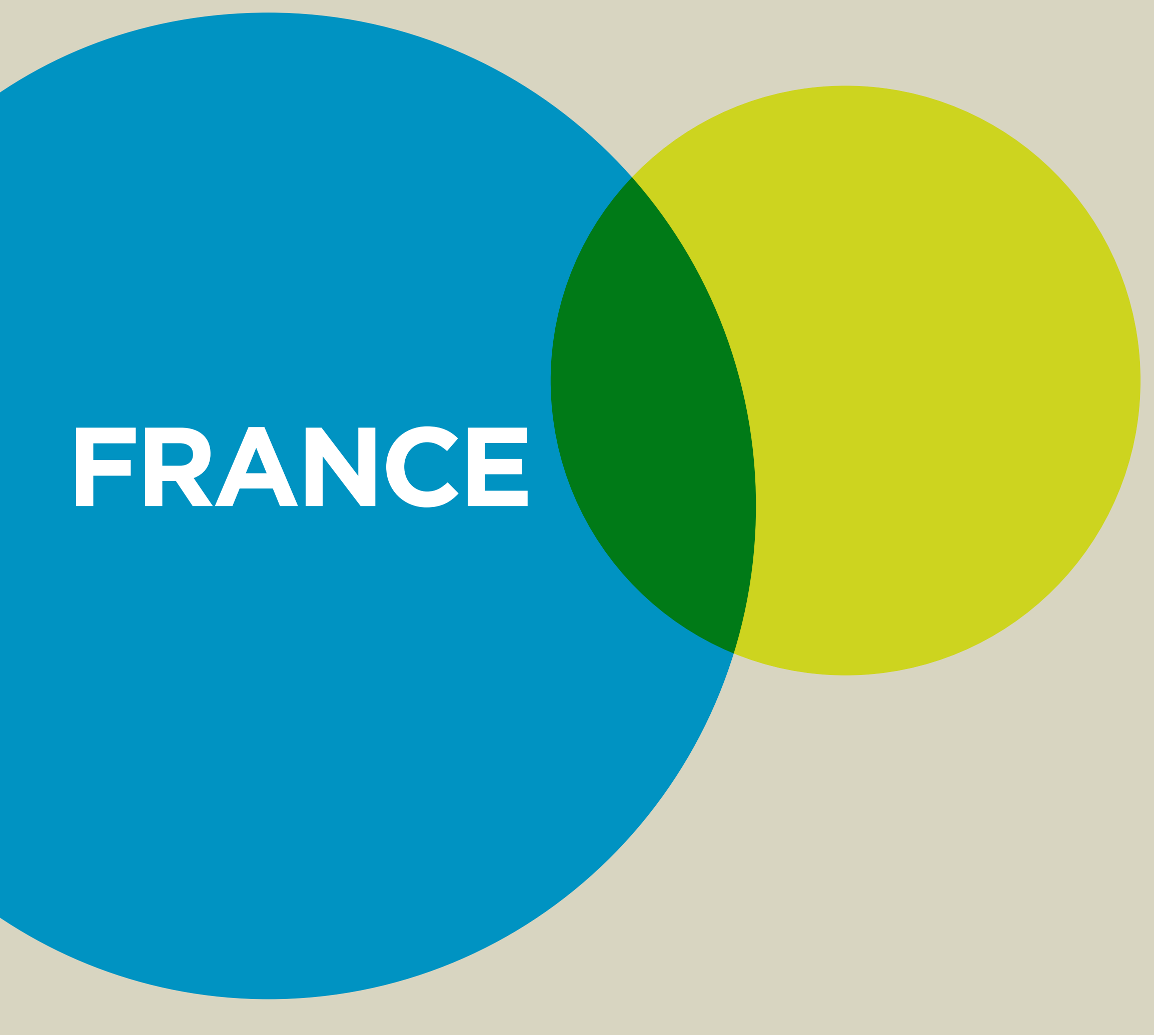
FRANCE

# FRANCE

## INTERNATIONAL DEVELOPMENTS

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

**Progressive reduction of the Corporate income tax (CIT) rate**

The French CIT rate should decrease progressively from 33.33% to 25% by 2022 (Finance Law for 2018, article 84). This measure is laid down as follows:

- In 2018, CIT rate is set at 28% until €500,000 of tax profit and 33.33% beyond
- In 2019, CIT rate would be 28% until €500,000 of tax profit and 31% beyond
- The standard CIT rate would be 28% in 2020, 26.5% in 2021 and 25% in 2022

**Removal of the 3% tax on dividends distributions**

Under article 235 ter ZCA of the French Tax Code (FTC), distributions made by French companies were subject to a 3% contribution in some circumstances. The 3% distribution tax was found to be contrary to the Parent-Subsidiary Directive (ECJ, 17 May 2017, 635/16) and to the French constitutional principle of equality before the law (CC, 6 October 2017, 660 QPC). As a result, the tax is repealed for dividend distributions paid out from 1 January 2018 (Finance Law for 2018, article 38). Litigation to get a refund of this contribution is still possible for contributions paid in 2016 and 2017.

**Creation of 2 exceptional and temporary contributions to assist in financing the removal of the 3% distribution tax**

The Parliament has approved an exceptional contribution on profits in order to finance the reimbursement of the 3% distribution tax refund claims filed by taxpayers (First amended Finance Law for 2017, article 1st). The contributions apply only once, for fiscal years ending between 31 December 2017 and 30 December 2018.

- The first contribution of 15% calculated on the CIT applies to companies with an annual turnover of at least €1 billion bringing the effective rate to 39.43% (including the social contribution of 3.3% of article 235 ter ZC of the FTC)
- The second contribution of 15% calculated on the CIT also applies to companies with an annual turnover of at least €3 billion bringing the effective rate to 44.43% (including the social contribution of 3.3% of article 235 ter ZC of the FTC)

**Facilitation of the reorganisation regime**

The Court of Justice of the European Union and French Supreme administrative court ruled out in 2017 that the pre-approval which was required by the French tax authorities was contrary to the freedom of establishment (ECJ, 8 March 2017, Euro Park, C-14/16). In order to comply with these decisions, the Parliament has abolished the tax ruling procedure for cross-border restructuring operations set out in article 210 C of the FTC as of 1 January 2018 (Second amended Finance Law for 2017, article 23). The neutrality regime for mergers, contributions of businesses, spin-offs may apply when a contribution is made to a company located in a country that has signed a treaty with France including a mutual administrative assistance provision provided the transferred assets are recorded in the balance sheet of a French permanent establishment of the foreign company. A new specific tax return will now have to be completed in the context of the reorganisation.

Furthermore, the scope of restructuring operations eligible for the neutral merger tax regime has also been extended (Second amended Finance Law for 2017, article 23). A contribution of shares reinforcing an existing controlling situation will now be assimilated to a contribution of a complete and autonomous branch of activity eligible to the neutrality regime for mergers. Please note that the commitment to hold shares for a three-year

period provided for the contributing company under the neutrality regime for mergers has also been abolished. Nevertheless, in practice, the shares should have to be held for more than two years to benefit from the participation exemption regime.

## 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?

The 2014 Finance Bill introduced a new anti-hybrid financing measure limiting the deductibility of interests accrued to related party lenders. The right to deduct interest on loans paid between related parties is subject to the following new demonstration: the borrower must be able to prove, upon the tax authorities' request, that for the current fiscal year the lender is subject to a corporate income tax on the interest income received which is equal to at least 25% of the corporate income tax that would be due if computed under the French general rules (i.e. 8.33%) without consideration of the effective tax payment by the lender. The new rule is applicable to the fiscal year ending on or after 25 September 2013. The anti-hybrid rule represents France's first concrete step to give effect to the OECD base erosion and profit shifting (BEPS) project.

On 27 January 2015, the Council adopted an anti-abuse rule about the parent subsidiary regime. This clause has been included in French law by the amended Finance Law for 2015 which provides that the parent subsidiary regime is not applicable *"to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. (…) An arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality"*.

The new clause is applicable for fiscal years as from 1 January 2016.

Besides, since French legislation already provides for exit tax, CFC rule, or hybrid mismatches rules in compliance with ATAD, European Commission announced that France met the requirements to postpone the whole harmonisation of French legislation until 1 January 2024 at the latest.

The Second Amended Finance Law for 2017 has already introduced the general anti-abuse provision derived from ATAD with respect to the application of Corporate income tax neutrality to a reorganisation when the main purpose or of the main purposes of the operation is fraud or tax.

On 17 January 2018, the French Council of Ministers approved the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI).

# GENERAL

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

The main difference between share deals and asset deals is that the target company's historical liabilities are transferred when the transaction is structured as a share deal (with a normal three-year statute of limitation, which can in some circumstances be extended to ten years). Asset deals (i.e. straight sales of assets or going concerns) do not result in the transfer of pre-closing liabilities relating to the assets or going concern being transferred (except for the going concern's taxes on assets or activities transferred in the year the transaction occurs, for which the buyer may become jointly liable for a limited period of time).

Asset deals generally trigger a higher tax cost for the buyer. Indeed, acquiring shares of a target company is subject to reduced registration duties, the rate of which depends on the target's corporate form (i.e. for Société Anonyme (SA) or Société par Actions Simplifiés (SAS) – shares, the rate is 0.1% of the sale price). For other company shares, except for real estate companies (see 'special considerations for companies whose main asset is real estate' below) the rate is 3% of the sale price (or of the fair market value, if higher than the price agreed). An allowance is deductible from the basis assessment of registration duty. This allowance is equal to the ratio of the number of shares purchased divided by the total number of shares issued by the acquired company, multiplied by €23,000.

Some operations can be exempted from registration duty, in particular the acquisition of shares between companies forming part of the same group (controlled companies as defined by article L 233-3 of the Trade Code or tax-consolidated group), acquisition of shares further to operations (such as contribution of shares for shares and mergers) carried out under merger neutrality regimes, or acquisition of shares in companies placed under a safeguard procedure or judicial restructuring.

Asset deals, if the assets qualify all together as a going concern, are subject to transfer tax at:

- 0% up to €23,000
- 3% from €23,000 to €200,000
- 5% of the sale price exceeding €200,000
- Or for real estate assets (at a rate of 5.09% plus additional duties)

From a VAT standpoint, both deals should be neutral, provided the assets sold all together form a going concern. It should be noted that VAT implications may arise for sales of isolated assets or real estate assets.

From a corporate income tax standpoint, share deals do not impact the ability of the target company to carry forward Net Operating Losses (NOLs), which remain available in normal circumstances (see question 6 below).

In asset deals, only assets are transferred – any NOLs remain with the target company provided that such sale does not qualify as a change of activity (see question 6). In addition, share deals (structured as straight sales) do not allow, in principle, any step-up in basis value and do not impact the target company's amortisation plan of its assets (in terms of duration and depreciation value). But asset deals mechanically imply a step-up in the assets' amortisation basis, which then corresponds to the purchase price paid allocated to each asset. However, in both cases no goodwill may be amortised. It should also be noted that, in the case of an acquisition mainly from treated parties at a price higher than the fair market value, the tax authorities could further challenge the allowance but not the amortisation basis.

Finally, there are other slight differences between share deals and asset deals. For instance, in share deals, the target company's business tax (so-called contribution économique territoriale) liability is not impacted in any way. But asset deals could allow the buyer, subject to certain circumstances, to fall outside the scope of the business tax if the buyer is not the owner of the assets or going concern transferred on 1 January of the year the transaction occurs.

## 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?

As a general principle, share deals do not allow any step-up in value of any of the target company's assets. Prior to the sale, however, the target company may consider a global step-up of all its tangibles and financial assets. It should be noted that capital gains are booked as non-available reserves and trigger taxation at the normal corporate income tax rate (of 34.43% globally in 2019).

Tax-free restructurings (i.e. merger favourable or merger neutrality regimes allow benefiting from deferred taxation on capital gains on assets transferred by the merged or the contributing company) may also be contemplated. Such operations generally do not offer step-up opportunities when implemented between related parties. However, such operations are performed at fair market value and therefore allow a step-up in basis when implemented between two independent parties (subject to additional conditions).

In parallel, a contribution of an isolated asset (such as real estate property or trademarks under conditions) to the target company prior to the sale is treated for tax purposes as a straight sale and allows a transaction at fair market value. In that case the value of shares of the target company that has benefited from the contribution corresponds to the fair market value of isolated assets contributed. But such an operation triggers capital gains subject to tax at the normal corporate income tax rate and may not benefit from the merger-favourable regime and can imply registration duty exposures.

Operations such as straight sales or contributions of isolated assets within a tax-consolidated group are made at fair market value, while the related taxation is postponed until the end of the tax-consolidated group, the exit of the tax-consolidated group of one of the two companies, or the assets sold to a company that is not a member of the tax-consolidated group (correlatively, amortisation on the re-evaluated value is not possible).

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

In principle, the amortisation of goodwill is not allowed in France, either in share deals or asset deals. However, in some specific cases, pursuant to the regulation of the ANC dated 23 November 2015, depreciation can be recorded in the case there is any time limit on the use of the business asset (for example: concession).

Moreover, the regulation n° 2015-06 of the ANC also amended the accounting treatment of a "technical loss" resulting from a merger carried out at the net accounting value (difference, up to the latent capital gain on assets received in the frame of the merger, between (i) the net accounting value of the shares held by the absorbing company in the absorbed one; and (ii) the net asset value of the absorbed company). This "technical loss" was in principle recorded in the balance sheet of the absorbing company as a "goodwill" that could not be depreciated either from an accounting or tax standpoint.

Now, from an accounting purpose, if possible, such "technical loss" must be allocated to the underlying assets it relates to and be depreciated following the depreciation rules applicable to said underlying asset.

## 6. FROM A TAX PERSPECTIVE, THE DEPRECIATION OF A BUSINESS ASSET IS NOT ALLOWED. THEREFORE, EXTRA-ACCOUNTING ADJUSTMENTS WILL BE NECESSARY. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are several rules that relate to the deductibility of interest on borrowings. Some modifications are contemplated to introduce the ATAD deductibility provisions based on the EBITDA.

- **Interest rate limitation**

  Under the interest rate limitation when interest expenses are paid to a direct shareholder, the annual deductible interest rate is capped at a rate determined by the Tax Administration (e.g. 1.67% for the full year closed on 31 December 2017). However, when interest is paid to a related-party company (whether shareholder or not), the annual tax-deductible interest rate can be higher, provided the borrowing entity may demonstrate, with the provision of a dedicated supporting file, that this rate is at arm's length (i.e. a rate the company could have obtained from third party financial institutions in similar circumstances).

### Anti-hybrid legislation

The deduction of loan interest paid by a company subject to corporate income tax to a related company is allowed provided that the lender is subject to tax on profits on the interest received amounting to at least 25% of the tax as determined under French tax rules (i.e. 8.33%) This mechanism was enacted to limit the use of hybrid instruments which take advantage of different legal qualifications of the same flow between two countries and allowing the deduction of the financial interest accrued in France and the exemption of the corresponding interest income received by the lender abroad. This rule is applicable to interest incurred since 25 September 2013, irrespective of the date the loan was granted.

### Thin capitalisation rules

The amount of interest paid to related entities which exceeds the highest of the three following thresholds will not be tax deductible on a standalone basis:

- First threshold: amount of interest computed on one and a half times the net equity, i.e. the interest deductibility is limited by the following ratio: "net equity: debt from related parties = 1:1.5"
- Second threshold: 25% of the ordinary income before taxes, amortisation and interest paid to related entities
- Third threshold: interest received from related parties

In addition, third-party loans (including bank debt) which are guaranteed by a "related party" to the borrower are deemed to be related party debt for thin capitalisation purposes (or loans granted by a non-related company, guaranteed by a non-related company itself guaranteed by a related company to the borrower).

Moreover, it should be noted that specific rules apply within a tax-consolidated group. Indeed, subject to limitations, the parent company could be allowed to deduct from the group taxable income all or part of the non-deductible interest as determined on a standalone basis.

Finally, if the accounting consolidated group's debt/equity ratio is higher than the borrowing entity's own debt/ equity ratio, the limitation on the deduction of interest paid to related entities will not apply.

The consolidated group is defined as all the French and foreign entities under the control of the same ultimate parent company.

For the purposes of this comparison, only debts owed to third parties are taken into account for computing a group's debt/equity ratio, though both debts owed to third parties and related entities are taken into account for the computation of the debt/equity ratio of the borrowing entity.

In any case, if the fraction of non-deductible interest is lower than €150K, there will be no limitation.

The non-deductible fraction of interest due on the application of the thin capitalisation provision may be carried forward to the following tax year (Y+1) and offset against 25% of the ordinary income before taxes and depreciation of fixed assets. The remaining amount may then be carried forward to the following tax years but with an annual deduction of 5%.

### Acquisition of shares not controlled from European Union or European Economic Area Carrez amendment)

The deductibility of financial expenses linked to acquisition of shares qualifying as controlling interest is limited. Financial expenses are only deductible if the purchaser can demonstrate that it (or a company incorporated either in France or since 1 January 2018 in European Union or European Economic Area and belonging to the same economic group) actually makes the decisions relating to these shares and that it exercises a control or influence over the acquired company.

If the company fails to provide such evidence, a fraction of the expenses must be added back to its taxable income for the acquisition accounting period and the following eight years.

However, the limitation does not apply when:

- The value of shares held by a company is less than €1 million
- The acquisition has not been financed by a loan
- The debt ratio of its group is higher or equal to the purchaser's own debt ratio

It should be noted that the new safe harbor provision regarding the case of the controlling entity established in the EU or in European Economic Area has been introduced by the Finance Law for 2018.

**Proportional interest deduction restriction "French rabot"**

Deduction of financial expenses of companies is now subject to a general limitation. For the accounting period ended as of 31 December 2012 companies have to add-back to their taxable result 25% of their "net financial expenses".

"Net financial expenses" are defined as the difference between the total amount of financial expenses incurred as a consideration for financing granted to the company and the total financial income received by the company in consideration for financing granted by the latter. Rents incurred under a moveable properties rental agreement between related parties or a leasing agreement are included in financial expenses after deduction of the amortisation, financial amortisation of the lessor and all costs invoiced by the lessee.

In a tax consolidated group, this limitation applies at the level of the tax result of the group. There is no carry-forward mechanism of disallowed interest. This limitation will not apply if the company's net financial expenses (or net financial expenses of the group for tax consolidation) are lower than €3 million.

Financial expenses related to the acquisition or building of assets within the framework of public utilities' delegation, concession of public engineering and public-private partnership agreements or an administrative long-term lease concluded before 28 December 2012 are all excluded from this mechanism.

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

The most straightforward solutions to push-down debt consist in a dividend distribution up to the target company's distribution capacity or the relocation of assets between the target company and an affiliated company. Both operations would be financed by a loan granted by an affiliated company or third party (e.g. a bank).

Therefore, the strategy in a debt push-down could consist in the creation of or increase in dividend distribution capacities (based on accounting rules) without triggering tax consequences. Such an outcome may be reached through operations made at fair market value with a limited tax impact, such as the straight sale of shares benefiting from the participation exemption regime (i.e. with an effective tax rate of 4.13%).

Another solution could be a relocation of assets (e.g. shares) held by the target company under the target company's subsidiary. Such an acquisition could be financed by debt. Further to this operation, the target company could distribute the capital gain realised to the holding company. In order to be tax neutral, the relocation of assets other than shares benefiting from the participation exemption regime could be contemplated between members of the same tax-consolidated group (see section 2 above and section 9 below).

French tax authorities try to deny the deduction of the interests related to the acquisition of a company if the holding company decides to merge the target company in a short period of time after the acquisition. However, the French tax authorities recently decided to allow the realisation of a quick merger between two holding companies, namely in the case of a secondary leveraged buy-out.

In any case, these schemes have to be analysed in light of French commercial law, which prohibits a company from financing its own acquisition.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no specific tax incentives for equity financing.

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

**On a stand-alone basis**

The acquisition of the target company's shares does not have any impact on the amount of the available losses carried forward by the target company, it being specified losses are not available unless the target company changes its activity.

An addition of business activity can characterise a change in activity where, during the fiscal year of the change or the following fiscal year in comparison with the fiscal year preceding the change, there is an increase of more than 50% of:

- The company's turnover
- The average number of staff and the gross amount of fixed assets

A surrender or transfer, even partial, of a business activity may also characterise a change in activity if there is a decrease of more than 50% of the previous criteria.

However, if the target company, which owns losses, is merged into another company, the losses can be transferred to the merging company only if a ruling is given by the French Tax Authorities. In particular, the activity of the merged company has to be maintained for at least three years. The transfer of tax losses is not allowed if the merged company is a holding company. Attention also has to be paid to the consequences of such merger on the merging entity's right to carry forward its own standalone tax losses further to the merger (i.e. impact on its own activity).

**On a group basis**

In principle, all the tax losses born within the tax consolidated group remain at the level of the head of the group when the said tax group vanishes. These tax losses are then only offset-able by the former head of the group against its own profits.

However, the former head of the tax group may elect for the enlarged basis imputation mechanism (i.e., *"imputation des deficits fiscaux sur une base élargie"*) which allows the offset of the previous collective tax losses carried-forward and generated by the companies of the former tax group against the taxable profits realised by such companies and members of the new tax group.

It should be underlined that the significant change in the activity of a subsidiary member of a tax consolidated group does not trigger any vanishing of the carried-forward tax losses it transmitted to the tax consolidated group. The only tax losses which would be definitively lost are those eventually generated by this subsidiary before its entry in the tax consolidated group.

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

Although it may be underlined that each transaction requires the performance of a tax due diligence on a case-by-case basis, i.e. the review of the tax specificities linked to the activity carried out by the target group, the following items should generally be considered every time a due diligence concerns a French company:

### Losses carry-forward rules

- General rules
  As from 1 January 2004, losses may be carried forward indefinitely. However, it shall be specified the offset-able amount of losses carried forward is limited, i.e. losses carried-forward shall only be fully offset-able against the following year's taxable income up to €1m, and for an amount equal to 50% of the portion of income exceeding 1 million (the remaining 50% of income shall be taxed at the general CIT rate). With respect to carry back, it is limited to one year, capped to €1m. Any excess tax loss is still available for carry forward.
- Change of activity
  By way of principle, the cessation of a business activity causes notably the vanishing of the carried-forward tax losses of the company. Moreover, a significant change in the activity carried on by the company as well as the loss of its operating resources may trigger the same consequences (we refer to question 9 for a definition of the "change of activity" under the FTC).

### Specific filing requirements

French companies are required to file several forms as notably Income from securities and interest returns ("IFU"), and Wages, commissions and fees tax returns ("DAS 2").

In case of a tax audit, failure to fill the above-mentioned forms entails the payment of a fine equal to 50% of the amount which should have been reported.

Capital gains whose taxation has been deferred upon a tax neutral operation must be followed-up by the filling of "54 septies" forms, otherwise a 5% penalty applies on the amount of deferred profits which were not included in the statement.

From 2018, the removal of the formal pre-approval from French tax authorities for international reorganisations has been replaced by the filing of a specific post-declaration of the reorganisation to assess the motivations and consequences of this operation.  The failure to comply with this requirement shall result in a fixed fine of €10,000.

### Statute of limitations

As a general rule, the FTA is entitled to audit a FY until the end of the third calendar year following the closing of the said FY. The FTA is in principle not entitled to conduct a new tax audit in the premises of a company which has already been tax audited in relation to the same tax and for the same FY. Other statutes of limitation are provided by French legislation, e.g. in the event of abuse of law.

However, when the company is in a tax loss position, the FTA is entitled to audit the validity of such losses until the end of the third year following the one during which losses have been offset.

### Specific tax credits

French legislation provides for certain tax credits whose scope and modalities of application should be focused on, e.g. Research tax credit ("CIR").

### French tax Authorities' practice

The question of the deduction of financial charges paid for intra-group loans is a new frequent reason for adjustment during tax audits. In practice, the tax authorities consider that when intra-group financing is set up, a company must have a loan offer issued by a bank to justify the normality of the interest rate applied, which is not always the case. For this purpose, the tax Authorities refer to Sections 39, 1-3° and 212 of FTC whereby, in the context of intra-group financing transactions, only interests calculated on the basis of a reference rate applied by credit institutions are deductible (i.e. 1.67% for 2017).

Besides, an emerging practice of French tax authorities consists in challenging the benefit of the tax consolidation regime based on criteria related to option formalities and alignment exercise periods of member companies.

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

The acquisition of shares is subject to reduced registration duties. The rate depends on the target company's corporate form. For SA or SAS companies, the rate is 0.1% of the sale price. For other company shares, except for real estate companies (see section 16 below), the rate is 3% of the sale price. An allowance is deductible from the basis of assessment of the registration duty. This allowance is equal to the ratio of number of shares purchased divided by total number of shares issued by the acquired company, multiplied by €23,000.

Note that in cases of mergers and assimilated operations, Article 816 of the FTC provides for a fixed registration fee of €375, increased to €500 for companies with a capital of at least €225,000.

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

Acquisition costs of shares mainly include registration duties, commissions, fees (auditor fees, external appraiser fees, advisor fees) and deed expenses related to the acquisition.

From an accounting standpoint, these costs may be taken into consideration in the acquisition cost of the shares or deducted for the FY where they have been incurred.

From a tax standpoint, the costs incurred to acquire shares qualifying as a controlling interest must be incorporated into the acquisition cost of said controlling interest. However, the deduction of acquisition costs may be spread over a 5-year period. In case of acquisition in the course of a fiscal year, the first annuity is computed pro-rata temporarily.

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

As a matter of principle, based on ECJ case law and guidelines issued by the French tax administration, input VAT on acquisition costs may only be recoverable if the acquiring company provides services subject to VAT.

Note, however, that in the case where the acquiring company would receive non-ancillary financial income, its right to recover input VAT could be reduced.

In principle, the reception of dividends by the acquiring company from its subsidiaries should have no impact on its right to recover input VAT on acquisition costs.

The ECJ (in EUCJ, Beteilingungsgesellschaft Larentia + Minerva mbH & Co KG, C-108/14 & C-109/14, 16 July 2015) and the French Supreme Court (in CE 20 Mai 2016 n°371940, 8e et 3e ch réunies., min c/ SA Groupe Ingérierie Europe Ginger) recently restated the principle that to the extent that the acquiring companies provides management services to each of its subsidiaries, input VAT related to acquisition costs should be fully deductible subject to its VAT taxation ratio.

However, it should be noted that in a recent case law, the French Supreme Court (in CE 23 Janvier 215 n°365520, Sté Lagardère SCA) seems to limit the possibility of a holding company to recover the input VAT on recharged costs if no services are provided (pure holding company).

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

We refer to question 20 and question 6 as regards the "Acquisition of shares not controlled from France (Carrez amendment)".

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

Under the Charasse amendment, anti-debt push down regulations provide for a partial recapture of the financial expenses borne by a tax consolidated group in case of transactions deemed to qualify as self-purchases.

The Charasse amendment applies:

When the shares of a company have been purchased by another company from parties who also directly or indirectly control (de jure or de facto) the acquiring company at the time of acquisition;

Where both the acquired and acquiring companies become members of the same tax-consolidated group after the transaction (including by way of merger).

This rule leads to the non-deductibility of the interest expense within the tax consolidated group up to an amount equal to: Financial expenses x [(acquisition price – amount of contribution in cash)/average group debt].

This reinstatement applies to the acquisition accounting period and the following eight years.

The Charasse amendment no longer applies to cases involving a change in control of the acquiring company. Moreover, the Charasse amendment is no longer triggered when a subsidiary held by a company directly acquired by the investor is immediately sold to a French holding company that elects to set up a tax consolidated group (relocation after an acquisition).

Mergers, spin-offs or split-offs may benefit from tax neutrality and are generally made within a group at book value (we refer to question 21).

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

For capital gains tax purposes, a real estate company is a company with assets made up of more than 50% of French real estate assets at the date of the transfer or at the closing date of the last fiscal year. Properties used for the purpose of a commercial activity are not deemed to be real estate assets for capital gain purposes.

For transfer tax purposes a real estate company is a company with assets made up of more than 50% of French real estate at any time of the year preceding the sale.

**a) Share deal**

Capital gains on the transfer of shares in real estate companies subject to corporate income tax are taxed at the normal corporate income tax rate (i.e. maximum effective rate of 34.43%). The favourable regime of participation exemption (i.e. effective tax rate of 4.13%) does not apply to the transfer of shares in real estate companies.

The acquisition of shares in a real estate company is subject to transfer duties at the rate of 5% of the fair market value of the shares.

**b) Asset deal**

Capital gains on the transfer of assets in real estate companies are subject to corporate income tax are taxed at the normal corporate income tax rate.

The acquisition of a real estate asset is subject to transfer duties at the rate of 5.09% of the fair market value of the estate asset.

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

French related companies subject to corporate tax may elect to form a tax-consolidated group provided that some conditions are met (e.g. companies held at more than 95% by the head company). It remains an election and companies should not elect before considering the overall advantages and disadvantages regarding this tax regime.

As far as advantages are concerned, the following main benefits may notably be granted by a French tax group regime:

- The parent company files a consolidated return, thereby allowing the offset of losses of one group entity against the profits of the other consolidated companies. The parent company then pays CIT based on the tax group result, after certain adjustments are made (e.g. adjustments for intra-group provisions, debt waivers, capital gains realised on asset / share transfers).
- Regarding intra-group dividend distributions within a tax-consolidated group, further to Steria case law (ECJ Steria, 2 September 2015, aff. C-386/14), two different regimes coexist:
  - Where the parent subsidiary regime is not applicable, intra-group dividends are fully neutralised at the level of the group income as from the second FY of the tax consolidated group.
  - Where the parent subsidiary regime is applicable, a 1% lump-sum amount remains taxable. This provision applies as from the first FY of the tax consolidated group. Please note that the taxation of a 1% lump-sum also applies for dividends paid by European subsidiaries which would satisfy conditions to enter in a French tax consolidated group if they were established in France.
- Regarding the application of thin capitalisation rules to tax consolidated companies (Section 223 B of the FTC), thin capitalisation rules described under Question 6 apply to each company that is a member of the group taken separately.

  Nevertheless, any excess interest recaptured in the individual results shall not be deductible at tax consolidated group level.

  Subject to limitations, the parent company shall thus be allowed to deduct excess interest incurred at the level of the tax consolidated companies and to carry forward the remaining amount of excess interest to the following tax years after the annual deduction of 5%.

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

Article 39 terdecies of the FTC provides for a reduced 15% rate of CIT on royalties and capital gains from qualifying intellectual property (IP). French and European patents, patentable inventions and some production processes accessory thereto are deemed as such. However, other IP rights such as trademarks, design rights, software and mere know-how are not included. IP rights only qualify under the regime if they are classified as an asset in the company's statutory accounts. As well as full ownership, the reduced rate may apply to rights received under license and sub-license agreements.

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

There is no specific adverse rule provided for the transfer of assets outside France.

## 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?

**a) Share deal**

- **Capital gains derived by French companies**

Capital gains derived from the sale of qualifying participations are only subject to CIT on a 12% lump-sum, resulting in a taxation at the effective rate of 4.13%.

Qualifying participations must satisfy both of the following conditions:

- They must be qualified as controlling interest (specific class of shares for accounting purposes that enables the shareholder to have a controlling interest) or, be eligible for the dividend participation exemption regime (provided 5% of the voting rights in the subsidiary's capital are held)
- They must have been held for at least two years before their sale

A reduced 15% tax rate applies to the following:

- Capital gains derived from sales of shares in venture mutual funds and venture capital investment companies if these shares have been held for a period of at least five years
- Capital gains realised on patents or patentable rights held for at least two years, unless the disposal takes place between related companies

Capital gains derived from sales of participating interests in companies that are predominantly real estate companies are subject to tax at the standard rate of 33.33%. For listed real estate companies, the rate is reduced to 19%.

- **Capital gains derived by non-resident companies**

For non-French tax resident companies subject to the provisions of relevant tax treaties having a substantial shareholding provision (e.g. those with Spain, Italy, Hungary, etc.), capital gains on shares held in a French company are subject to tax at the standard CIT rate of 33.33% provided the foreign selling entity has held, at any time during the five years preceding the sale, directly or indirectly, more than 25% of the French company's share capital of the French company (section 244 bis-B of the French Tax Code).

According to the new French tax guidelines, the foreign seller is allowed to claim, under certain conditions and through the formal process, for a refund of the paid tax exceeding the effective tax burden.

**b) Asset deal**

If a French company sells assets, the capital gain is taxable at the normal corporate income tax rate (i.e. maximum effective rate of 34.43%).

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

There is no specific advantage to reinvest the proceeds of a sale. If the seller is a fund, subject to conditions, no taxation arises at the level of the fund's interest holders as long as no cash is distributed.

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

The local substance requirements for holding companies are minimum staff, offices, location of board meetings, decision power, etc. However, the substance must be in relation to the activity of the company, i.e. the substance-level requirement is different between an operating company, a financial company and a non-operating holding which only manages its shareholding. Consequently, the substance level requirements for non-operating holdings are necessarily limited.

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

- **Accounting principles**

As regards the transcription modalities of the transfer, it shall be noted that contributions have to be translated in the beneficiary company's books under the following accounting rules (French GAAP), i.e. at the net book value (usually where the parties involved are under common control, that is, when the merging company controls the merged company or when both of them are under the control of a third party) or at the fair market value (usually where parties involved are non-related parties and where the main shareholder of the merging company keeps the control of the remaining entity).

- **Tax principles**
- **CIT**
- **Common regime**

Under common regime, mergers/spin-offs imply the consequences of enterprise cessation, i.e.:

- Provisions and latent capital gains taxation at CIT
- Registration duties applicable to contributions made to a company (depending on the nature of the contribution)

- **Specific neutral regime**

Under special regime, mergers/spin-offs benefit from favorable provisions as regards CIT and registration duties, provided certain requirements are met, including accounting requirements.

Upon election, Section 210 A of the FTC contains a special system of CIT applicable to the mergers mainly resulting in the deferral of capital gains and provisions taxation (unless provisions are no longer required) at the level of the contributing company.

In order for the merger/spin-off special regime to apply, in addition to the express election for the application of the special regime, the beneficiary company shall comply with several requirements to allow the future taxation of capital gains and provisions which were exempt from tax at the time of the merger/spin-off, e.g. record all the transferred assets for the value they had in the merged company books.

However, if the merger is concluded with retroactive effect from the beginning of the FY, the normal business result would be included in the taxable profits of the beneficiary company.

At the level of the beneficiary company, the capital gains arising from the cancellation of its interest in the contributing company due on a merger are tax exempt.

- **VAT**

VAT exemption is applicable where the transaction qualifies as a transfer of a going concern within the meaning of French and European Union law, such as a transfer of a business. On the transfer of a business, the exemption applies to the disposal, subject to payment, of all the assets constituting the business (i.e. intangible and tangible assets excluding real estate).

- **Registration duties**

  Pursuant to Section 816 of the FTC, mergers and assimilated operations benefiting from the merger tax regime of Section 210 A, trigger fixed registration duties amounting to €500 (€375 for companies whose share capital is less than €225k).

  Real estate properties transferred in the frame of a merger benefiting from the merger tax regime of Section 210 A are however subject to a real estate publicity fees (contribution de sécurité immobilière) amounting to 0.10% of the value of the properties received (Section 879 of the FTC).

  If the real estate property transfer is realised in the frame of winding up, an additional real estate publicity fees of 0.715% (taxe de publicité foncière) will be due on the value of the property received.

- **Other considerations**

- **Tax losses**

  The transfer of carried-forward tax losses in case of merger or similar restructuring operation is notably subject to the condition that the activity that originated the tax losses did not suffer any significant change in terms of customers, staff, operating resources, nature and volume of activity, otherwise the transfer would be subject to a ruling granted by the FTA.

- **Quick merger**

  French tax authorities try to deny the deduction of interest related to the acquisition of a company if the holding company decides to merge the target company in a short period of time after the acquisition. However, the French tax authorities recently decided to allow the realisation of a quick merger between two holding companies, namely in the case of a secondary leveraged buy-out.

  In any case, these schemes have to be analysed in light of French commercial law, which prohibits a company from financing its own acquisition.

- **Acquisition costs**

  Where participation shares are transferred to the merging company due to the merger, and provided the merger benefits from the special regime above-mentioned, the absorbing company is allowed to continue to proceed to the amortisation or deduction of the acquisition costs included in the participation securities' cost price (on the time left to amortise).

  Where participation shares are cancelled in the merging company's accounts following the merger, the gain or loss realised must be determined on the basis of the tax value of the cancelled shares, i.e., the cost value majored by the acquisition cost related to these shares, and minored by the amortisation or deduction amount already performed.

## MANAGEMENT INCENTIVES

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

- **New taxation rules for individuals**

  The gain realised by managers benefiting from management incentives may be taxed differently depending on whether it is qualified by the FTA as a capital gain or as a salary.

  Until 1 January 2018, financial income such as dividends, interest, and capital gains on the sale of shares earned by individuals was subject to French annual income tax at progressive rates (up to 45%), exceptional contributions on high income (up to 4%), and to social contributions (15.5% in 2017).

The Finance Law for 2018 introduced a 30% flat tax on financial income (interest, capital gains, carried interest, distributions and similar income), composed of a 12.8% income tax, and 17.2% social contributions (Finance Law for 2018, article 28). The contribution on high income (up to 4%) however remains in place in addition to the 30% (leading to a global rate of 34%).

**Free shares plan**

For free shares issued in relation with free shares plan voted as of 1 January 2018, the following regime applies:

- As regards acquisition gains (the share value is fixed at the vesting date), the portion that does not exceed €300,000 benefits from a global deduction of 50% for the calculation of individual income tax at the progressive rate and remains subject to social contribution of 17.2% whereas the portion exceeding is still treated as salary at the progressive income tax rate.

An employer contribution of 30% also applies at the date of the granting.

- As regards capital gains (difference between the selling price and the acquisition gain), the taxable basis is subject to the 30% flat tax (including 17.2% of social contributions). The tax is due at the time of the sale of the shares.

**Risk in relation with management packages**

The FTA reserves the right to deny the qualification of "capital gain" and requalify in "salary" the gain realised by managers where the latter have not borne a real investor's risk, i.e. where managers have benefited from a more favorable treatment due to their salaried activity.

- From a tax standpoint, the qualification as employment income will be borne by the manager benefitting from the management plan (individual tax at 45% vs 12.8% for capital gains on top of the 17.8% of social contributions and the potential 4% tax on high level income)
- From a social contribution standpoint, the qualification as employment income can trigger a social contribution burden for the company employing the manager (depending upon the remuneration of each manager but amounting to circa 50% of the income earned by the manager). Indeed, this principle has been provided by a recent case law (Court of Appeal of Paris, 6 July 2017, SAS Groupe Lucien Barriere vs URSSAF – Ile de France 14/02741). Please note that an appeal has been lodged against this decision and we are waiting for the decision of the Supreme Court.

To date, based on case law, the FTA notably pays particular attention to the following key elements:

- the link between the investment realised and the function performed, i.e. whether the management package replaces an element of remuneration of the manager (link with the manager's salaried activity)
- advantages eventually granted at the entry and at the exit to the managers, i.e. whether the management package constitutes a risky capital investment or not.

For that purpose, it is important to limit the corroborating evidences notably if it is not possible to avoid the good/bad leaver provision in the agreement with the managers. After a review of the contemplated term sheet
of management package plan, we would recommend the following

- An accurate market value of the shares is key
- The management package requires the existence of a capital risk

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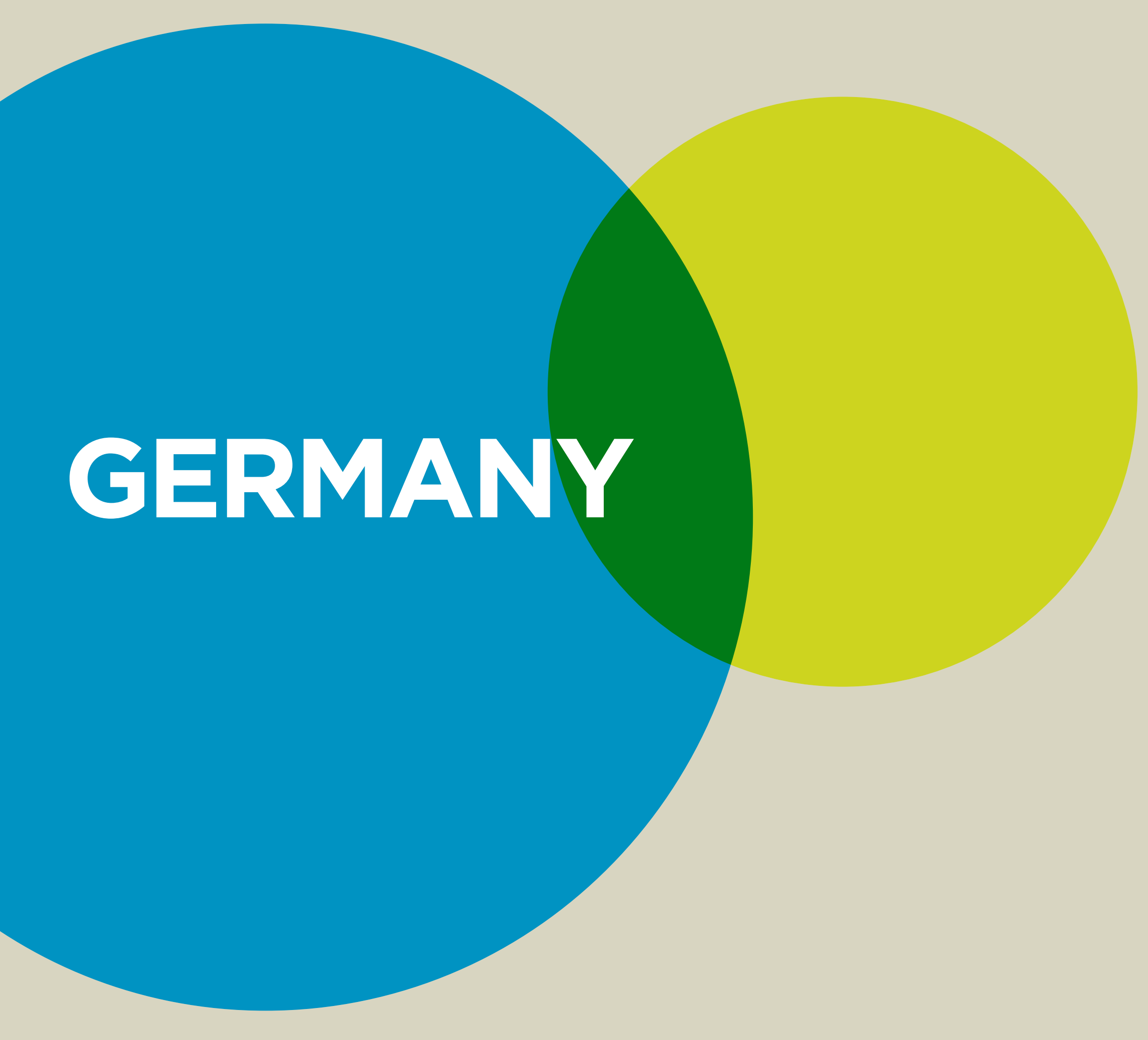

# GERMANY

# GERMANY

## INTERNATIONAL DEVELOPMENTS

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

Germany has recently seen some legislative developments with relevance for M&A deals and private equity.

Regarding the tax loss forfeiture rules for harmful transfers of more than 25% or 50% of the shares in a target entity (change-of-control), the tax legislation introduced an additional rule which, at the taxpayer's request, is applied instead of the general rules to allow – under very strict conditions – the preservation of losses in the case of a continuation of business (see no. 9 below).

Another important development was that the German Federal Constitutional Court (*Bundesverfassungsgericht*) in its decision of 29 March 2017 declared the proportional loss forfeiture for the transfer of more than 25% up to 50% in the years 2008 to 2015 unconstitutional unless the legislature creates a constitutional and retroactively applicable new regulation. According to the draft Annual Tax Act 2018 the loss forfeiture shall not apply to such changes in ownership of up to 50% that have occurred in the years 2008 to 2015. The question as to whether the complete loss forfeiture for a transfer of more than 50% of the shares is unconstitutional is currently pending.

A third significant development with respect to tax loss forfeiture rules was the European Court of Justice (ECJ) decision of 28 June 2018 in which the ECJ annulled a decision by the European Commission in 2011 on the state aid status of the restructuring clause (*Sanierungsklausel*), arguing that the European commission applied an incorrect reference system for purposes of the selectivity analysis. This restructuring clause, under certain conditions, allows to prevent the application of the loss forfeiture rules in spite of a harmful change in ownership. The draft Annual Tax Act 2018 includes a provision that reinstates the restructuring clause retroactively to 2008. However, it is unclear whether the ECJ confirmed that the restructuring clause is not an unlawful state aid.

The tax legislation also adopted a license barrier which, as of 1 January 2018, restricts the tax deductibility of license fees and royalties paid by German taxpayers to related parties if at the recipient's level such payments are subject to low taxation (see no. 18 below).

The German Federal Tax Court (*Bundesfinanzhof*) ruled on 31 May 2017 that a capital gain realised by a corporation from the sale of shares in another corporation is 100% tax-exempt if the selling corporation is non-domestic and does not have a permanent establishment or representative in Germany (see no. 14 below).

In the past, financial restructurings were facilitated by the tax authorities' restructuring decree (*Sanierungserlass*) dated 27 March 2013 declaring that subject to certain conditions a debt waiver gain is not taxed. In its resolution of 28 November 2016, the Grand Senate of the German Federal Tax Court abolished this restructuring decree because it had no statutory basis. The German legislature then basically converted the restructuring decree into statutory law. This new law applies retrospectively for all debt waivers effected after 8 February 2017 but is currently subject to notification by the European Commission in order to avoid potential state aid risks. For any debt waivers effected up to and including 8 February 2017, the German Federal Ministry of Finance (*Bundesfinanzministerium*) stated in a circular that the restructuring decree continues to be applicable. However, the German Federal Tax Court recently also abolished this circular with the effect that for such "old" debt waivers taxpayers generally cannot rely on the applicability of the restructuring decree.

M&A deals could also be affected by possible amendments of the Real Estate Transfer Tax (RETT) Act. The Ministers of Finance of the Federal States agreed on new RETT rules for share deals. Firstly, it is proposed to lower the harmful threshold of direct and indirect share transfers in real estate holding companies from 95% to 90%. Secondly, an additional RETT event for corporations holding real estate shall be implemented, where (similarly to the existing rules for partnerships) the transfer of at least 90% of the shares in a corporation within a period of ten years will be subject to RETT, i.e. also the transfer to two or more unrelated investors would trigger RETT. Thirdly, the holding periods, e.g. for the seller regarding its minority interest in a partnership holding real

estate as well as for certain RETT exemptions, shall be extended from five to ten years. Certain consequential amendments to the RETT Act are possible. However, no draft law on the new RETT rules has been published yet. Against this background, especially in cases where a share transfer of more than 90% of the shares or interests is currently envisaged, the legislative process should be monitored closely.

Finally, it is important to note that the envisaged tightening of the rules dealing with the tax-exemption of capital gains deriving from the disposal of shares in corporations by corporations (i.e. a 10% minimum shareholding criteria) has not been introduced yet and is currently not included in any tax bill. However, it cannot be ruled out that the restriction will be enacted at a later stage.

## 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?

**OECD BEPS**

Germany generally supports the BEPS actions. German tax law already covers many aspects of the BEPS action plan (e.g. interest barrier rules, CFC rules). With effect from 2017 and 2018 respectively, Germany implemented provisions reflecting BEPS Actions 5 and 13. With regard to Action 5, Germany introduced a limitation rule for license fees and royalties (see no. 18 below). Furthermore, in order to implement Action 13, Germany changed its General Tax Act so that multinational enterprises are now required to submit master and local files as well as country-by-country reporting. In addition, several existing tax rules have been changed in order to challenge treaty shopping. It is not unlikely that further provisions, in particular regarding hybrid mismatches (Action 2),
will be introduced in future.

On 7 June 2017, Germany signed the OECD Multilateral Instrument, a convention to modify existing double tax treaties under BEPS Action 15 with the aim of reducing opportunities for tax avoidance by multinational enterprises.

**Parent-Subsidiary Directive**

The amendments of the Parent-Subsidiary Directive in July 2014 (introducing subject-to-tax clause and correspondence principle) and January 2015 (introducing a general anti-abuse clause) were in principle enacted in German tax law.

**Anti-Tax Avoidance Directive**

Most of the rules of the Anti-Tax Avoidance Directive (e.g. interest barrier rule, exit taxation) are already included in German tax law. Therefore, no significant amendments are expected in this respect. However, the German legislature might take the opportunity to modernise the German CFC rules in light of Article 7 of the Directive.

**Mutual Assistance Directive**

In connection with BEPS Action 5, the European Commission – with its proposal dated June 2017 – intends to amend Council Directive 2011/16/EU on administrative co-operation in the field of taxation and repeal Directive 77/799/EEC (Mutual Assistance Directive) by introducing special disclosure obligations for potentially aggressive tax planning arrangements with cross-border implications. In its corresponding recommendations, the German Federal Council (Bundesrat) proposes to extend such reporting obligations to national tax planning arrangements.

## GENERAL

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

**A) Share deal**

In a share deal, no step-up of the book value of the assets in the target company is possible for the buyer. Instead, the (high) acquisition costs are only reflected in the book value of the acquired shares and will thereby only reduce a potential future capital gain (which in the case of a corporate seller is 95% tax exempt) provided that the future exit takes place at this level. Further, the buyer acquires all tax risks from prior years associated with the company's shares and therefore should request tax guarantees/indemnity from the seller. If the target company owns German real estate with considerable value, a share deal might enable the buyer to mitigate or even avoid RETT (regarding potential changes of the law see no. 1 above). Various options are available for the buyer to achieve a debt-push down (e.g. down-stream merger, implementation of fiscal unity). Whether arm's-length interest expense is deductible for tax purposes depends on the requirements of the interest barrier rule (see no. 6 below).

From a corporate seller's perspective, the main advantage of a share deal is that the capital gain deriving from the disposal of shares is in principle 95% tax-exempt. However, capital losses from share deals are not tax-deductible at all. At the level of the target corporation (and its subsidiaries), losses carried forward and current losses up to the transfer date might be forfeited under the loss forfeiture rules (unless certain exceptions are fulfilled). Share transfers are generally VAT-exempt. Depending on the VAT situation of the seller and the purchaser, the seller can opt for regular VAT in order to improve the deductibility of input VAT on transaction costs.

**B) Asset deal**

An asset deal gives the buyer the possibility to step up the book values of the acquired assets, including goodwill, up to the acquisition price. The subsequent depreciation results in lower tax burdens for the buyer in the future. In an asset deal, most of the tax risks from former years remain with the seller. However, if the asset deal qualifies as a transfer of a going concern (meaning the transfer of the whole business or separate business unit), there is a special regulation that the buyer could be subject to a secondary liability for certain business taxes of the seller resulting from the pre-acquisition period.

A debt push-down is not required as financing can be easily provided to the acquiring company. The deductibility of interest expense depends on the requirements of the interest barrier rule (see no. 6 below). Furthermore, the acquisition of assets is generally not exempt from VAT (unless the assets qualify as a going concern). This has to be carefully considered if the input VAT is not fully deductible for the buyer (e.g. in the event of a VAT-exempt turnover).

Please note that the acquisition of a partnership interest is treated like an asset deal (and not like a share deal) for German tax purposes. Therefore, there is a step-up of the value of the assets for the buyer when acquiring partnership interests. For (corporate) income tax purposes, depreciation of the stepped-up assets (shown in a supplementary tax balance sheet) is allocated directly to the acquiring partner. For trade tax purposes, an allocation of the stepped-up assets would need to be contractually agreed as in this case, not the respective partner but the partnership itself is the taxpayer.

For the seller, the asset deal is in principle a taxable event, except for a potential tax-neutral roll-over regarding land, buildings or vessels if the corresponding proceeds are reinvested (see no. 21). Capital gains could be offset against existing losses and loss carry-forwards of the seller. In this context the seller has to take into account Germany's minimum taxation rules. These rules limit the deduction of loss carry-forwards in a fiscal year to the amount of €1 million plus 60% of the income exceeding €1 million. The seller usually retains all tax risks from prior years associated with the business assets. Capital losses from an asset deal are in principle tax-deductible.

## 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?

German tax law in principle does not provide for a tax-neutral step-up of the value of tangible or intangible assets in a share deal. Various options (e.g. sale, merger) are available to achieve a taxable step-up of the assets after the share deal. In this context a tax benefit could be achieved only if existing losses or loss carry-forwards can neutralise the taxable capital gain. However, the minimum taxation rules have to be considered in cases where the taxable profit from the contribution exceeds €1 million and no sufficient losses of the current year are available (see no. 3b) above).

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

German tax law allows straight-line depreciation of goodwill over 15 years. For German GAAP purposes, however, the depreciation period of goodwill is generally 5 years.

Acquired intangible fixed assets are depreciated straight-line over their estimated useful lives (the costs of self-created intangible fixed assets must not be capitalised).

### 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?

The general limitations on the deductibility of interest expenses also apply to share and asset acquisitions.

- **Arm's length principle**

  The interest rate on borrowings from shareholders or related persons must comply with arm's length principles. This also requires that financing agreements are concluded beforehand and preferably in writing in order to prevent the tax authorities from denying the interest deductibility.

- **Interest barrier rules**

  According to the German interest barrier rules, a taxpayer is able to immediately deduct net interest expenses (interest expenses minus interest income) only up to 30% of the taxable earnings before interest, taxes, depreciation and amortisation (tax EBITDA). The tax EBITDA only includes taxable income and thus does not necessarily match with the GAAP EBITDA. The interest barrier rules apply to all interest and not only to interest on intra-group loans. The interest barrier rules allow EBITDA carry-forwards (broadly speaking, unused EBITDA in one year can be used to achieve an interest deduction in future years) and interest carry-forwards (non-deductible interest might be deductible in future years if there is sufficient EBITDA in such a year). Interest carry-forwards are subject to the change-of-ownership rules (see no. 9); EBITDA carry-forwards lapse after five years.

  The interest barrier rules do not apply if one of the following conditions is met:

  - The net interest expenses of the respective fiscal year (based on the tax authorities' view including any interest carry-forwards) are less than €3 million (exemption limit, no allowance),
  - The taxpayer is not part of a group of companies and the interest expense paid to a material shareholder or a related party or a back-to-back lender does not exceed 10% of the company's total net interest expense, or

- The taxpayer proves that the borrower's equity ratio is at least as high as the world-wide group's equity ratio. It is acceptable if the German entity's equity ratio is 2 percentage points below the group's ratio. This escape clause applies only if the taxpayer or any other group company is not shareholder-financed to a harmful extent; that is, if the taxpayer or any group company pays no more than 10% of its interest expense to a material shareholder or related party outside the group or to a third party secured by the material shareholder or related party.

**Add-back for trade tax purposes**

25% of the interest expense must be added back for trade tax purposes (to the extent an allowance for interest and certain other expenses in the overall amount of €100,000 is exceeded).

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

Various options are available to achieve a debt push-down. One is to implement a tax group (fiscal unity, "*Organschaft*") between the debt-financed German acquisition vehicle and the target company. Such a tax group, which requires (i) that the acquisition vehicle holds the majority in the voting rights of the target company, and (ii) the conclusion of a profit and loss transfer agreement, allows for a consolidation of the interest expense of the acquisition vehicle, resulting from the financing, with the profits of the target company. Alternatively, the acquisition vehicle and the target company can be merged. Leveraged distributions or repayments of (free) capital reserves of the target company are other potential options. When determining the level of debt financing, the German interest barrier rules have to be considered (see no. 6). The German capital maintenance rules also have to be kept in mind.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

German tax law does not provide for specific tax incentives for equity financing.

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

The direct or indirect transfer (or a similar transaction, such as a capital increase or an internal group restructuring) of more than 25% or 50% of the shares in a loss company to any shareholder or a group of shareholders with similar objectives within a 5-year period leads in principle to a partial or complete forfeiture of current tax losses and tax loss carry-forwards. The law provides for several options to avoid the forfeiture of losses and loss carry-forwards:

**Intra-group escape**

The acquisition of shares in principle no longer results in the loss (or partial loss) of losses and loss carry-forwards if the same taxpayer indirectly or directly holds 100% of the shares in both the transferring and the acquiring entity, the acquirer indirectly or directly holds 100% in the shares of the transferring entity, or the seller indirectly or directly holds 100% in the acquiring entity. Intra-group reorganisations that fulfill these (strict) requirements can therefore be carried out without the forfeiture of losses and loss carry-forwards.

**Hidden-reserve escape**

In addition, a corporation's unused tax losses are preserved to the extent they are compensated for by hidden reserves that have been built into those business assets of the corporation and that are subject to German taxation. If only between 25% and 50% of shares in the corporation are sold, the corresponding portion of hidden reserves is considered. The hidden reserves are evaluated by comparing the portion of the equity of the shareholder(s) that corresponds to the portion of the transferred shares with the fair market value of these shares. In a sale of more than 50% of the shares, the entire hidden reserves can be taken into account and be compared with the fair value of all shares.

- **Continued-business escape (implemented in 2017)**

  A new exemption came into effect on January 1, 2016. This rule allows for losses to be carried forward if the relevant company carried on its business for the three fiscal years prior to the year of the harmful transaction. However, certain transactions during those three years (e.g. being partner in a partnership or controlled company in a tax group) will prevent the application of the escape.

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

A number of specific items should be considered in a tax due diligence in Germany. They include (i) the validity of tax groups (fiscal unities) for income tax (e.g. actual execution of the profit and loss transfer agreement) and VAT purposes, (ii) the forfeiture of tax losses on the basis of the forfeiture rules and the applicability of exceptions (see no. 9), (iii) previous reorganisations and the existence of specific holding periods (to be observed in order to avoid a (retroactive) capital gains taxation of the initial tax-neutral transactions), and (iv) the limitation of interest deductibility due to the interest barrier rule (see no. 6) as well as the deductibility of license fees due to license barrier (since 2018, see no. 18). Further, it should be reviewed whether the target company could be liable for German RETT due to transactions with German real estate holding companies. Additionally, Germany applies a very specific tax regime to (German and foreign) partnerships which are considered as transparent for income tax purposes so that the respective partner of the partnership is liable to (corporate) income tax. However, for trade tax purposes, the partnership itself is liable to tax, which means that the partnership is liable for the capital gain triggered by the sale of a partnership interest.

With respect to repatriation of cash, German tax law includes an anti-treaty/directive-shopping provision. This rule requires the beneficiary of a distribution (dividends or royalties) to have sufficient substance and activities. This substance has to be proven to the Federal Central Tax Office in order to receive either a refund for WHT or an exemption certificate so that no WHT is due on future distributions. The ECJ recently held that the previous version of the rule was in violation of EU law (see ECJ of 20 December 2017, C-504/16 and C-616/16). Based thereon, the German Federal Ministry of Finance takes the position that (i) the old version of the anti-treaty/directive-shopping is basically no longer applicable and (ii) the new version is handled in a more favorable way for the taxpayer with respect to the substance and activities test (cf. decree of the Federal Ministry of Finance of 4 April 2018).

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

Germany does not impose any stamp duties or transfer tax on share transfers. However, if the target company (corporation or partnership) owns German real estate, under certain circumstances Germany levies RETT on a specially assessed property value (see no. 16).

The transfer of shares and partnership interests is in principle exempt from VAT. However, the supplier can opt to waive this VAT exemption (which in practice is usually not done).

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

Acquisition costs are generally not deductible but have to be capitalised and depreciated over the average useful life of the respective asset (if applicable; e.g. land and shares in corporations are not subject to depreciation). Incidental acquisition costs (e.g. for legal/tax advice) usually have to be allocated to the acquired assets and are – in principle – not immediately deductible but part of the pro rata depreciation (if applicable). An immediate deduction of such costs is possible if it can be proven that there is no economic connection between the acquired assets/shares and the corresponding costs. Financing-related costs (e.g. commitment fees or advisory costs in

connection with the financing) or costs for a W&I insurance (insurance premium, insurance tax) are only indirectly connected with the acquisition and, thus, immediately deductible. From a timing perspective, costs can only be classified as incidental acquisition costs if they incur after the purchase decision is basically made. In this respect, particularly the treatment of due diligence costs is controversial. Costs in regard to failed acquisitions are in principle immediately deductible. RETT paid in an asset deal has to be capitalised, whereas RETT triggered in a share deal transaction is in principle immediately deductible.

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

A VAT recovery requires that the person that wants to claim input VAT has to qualify as an entrepreneur for VAT purposes. It is further required that the acquired assets will be used for transactions subject to VAT. If VAT cannot be recovered on acquisition costs, it would increase the acquisition costs and be part of the pro rata depreciation (if applicable).

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

A foreign (non-German) acquiring company is subject to limited tax liability in Germany if it generates income from German sources. Income from German sources arises, for instance, if (i) shares or interest in a German entity with registered seat and/or place of management in Germany, (ii) real estate located in Germany, or (iii) assets belonging to a German permanent establishment, are acquired.

When a foreign company holds shares in a German corporation, withholding tax (WHT) of 25% (26.375% including solidarity surcharge of 5.5%) is generally levied on, for example, dividend or royalty payments by the German entity to its foreign shareholder. An applicable double tax treaty (DTT) or EU directive (e.g. Interest and License Fee Directive, Parent-Subsidiary Directive) might fully or partially reduce the German WHT burden. The German entity may abstain from WHT deduction only if an exemption certificate is issued by the German Federal Central Tax Office prior to the relevant payment. A reduction or refund (without a prior exemption certificate) of German WHT is subject to the fulfillment of certain requirements concerning the activity and substance of the direct or indirect foreign shareholder of the German entity (see also no. 10).

Please be aware that Germany's 95% tax exemption for dividend income is available for German and foreign shareholders only if the shareholding in the German company amounts to at least 10% for corporate income tax purposes and 15% for trade tax purposes (at the beginning of the fiscal year of the subsidiary in question).

Under most double tax treaties concluded by Germany, the taxation right for capital gains from the sale of shares in a corporation is attributed to the seller's state of residence (with the exception of shares in a German real estate company if more than 50% or 75% of that company's value consists of real estate located in Germany, for example, under the treaties with Luxembourg, the Netherlands, Poland or the UK), unless the shares are held through a German permanent establishment. In a case where Germany's taxation right was not excluded, the German Federal Tax Court recently ruled that capital gains from the sale of shares in a corporation realised by a non-domestic seller without a permanent establishment or permanent representative in Germany shall be 100% tax exempt.

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

- **Options for tax-neutral reorganisation measures**

  In particular the Reorganisation Tax Act provides for tax-neutral reorganisations such as mergers, spin-offs, hive-downs, conversions, contributions of shares or specific business assets. The full or partial tax neutrality for the transferring entity in principle requires that (i) Germany retains the right to tax a capital gain regarding

the assets transferred, (ii) the transferring entity receives only new shares in the receiving entity (or limited other consideration, see above), and (iii) the relevant entity files an application for tax neutrality with the competent tax office. If these requirements are met, the transferring entity may recognise the assets at tax book value, thereby avoiding a capital gain. These rules also apply to cross-border reorganisation measures.

German tax law also provides for structuring options outside the Reorganisation Tax Act. For instance, the assets of a partnership can be transferred to its sole remaining partner in a tax-neutral way.

**Tax group**

Tax groups (fiscal unities) can be beneficial in reorganisations (see no. 17). In particular in M&A deals with controlled entities a clear termination of the profit and loss transfer agreement has to be ensured. The SPA should provide for a reasonable allocation of tax risks before the transfer date. An acquisition can be structured in a way that the tax group with the selling controlling entity exists until the transfer date and a new tax group with the buyer starts as of the transfer date (e.g. by implementing short fiscal years).

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

The main issue to consider when acquiring companies whose main assets consist of German real estate is that Germany levies RETT on the direct or indirect transfer of such real estate. The tax rates vary between 3.5% and 6.5% depending on the federal state in which the real estate is located. In an asset deal, RETT is always triggered (the purchase price is the assessment base; no avoidance strategies are available).

In a transfer of interests in a partnership, RETT is basically levied if at least 95% of the partnership interests are transferred within a period of five years. A transfer of shares in corporations triggers RETT only if a buyer (or a RETT group) acquires at least 95% of the shares. The tax base is in principle the fair value of the real estate. RETT could be avoided by, for example, selling only 94.9% to a single purchaser and having the shareholder or a third party retain the remaining 5.1% shareholding. In this respect it is to be considered that (ongoing) M&A deals could be affected by possible amendments of the RETT Act (see no. 1). RETT relief might be available for certain reorganisation measures (e.g. mergers, spin-offs, hive-downs or contributions and share-for-share exchanges). This requires, among other things, that the controlling company directly or indirectly holds at least 95% of the shares in the controlled company involved in the reorganisation within the five years prior to the relevant transaction and for at least five years after it.

An increasing number of German DTTs allocate the right to tax a capital gain deriving from the disposal of shares to the state of residence of the target company if most of its assets comprise real estate (see also Art. 13(4) of the OECD Model Convention).

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

German tax law provides for tax groups (fiscal unity, “Organschaft”) for corporate income tax (CIT) and trade tax (TT) purposes as well as for VAT purposes.

**CIT and TT group**

The main benefit of a tax group is that all profits and losses of the tax group members are pooled at the level of the controlling parent company. In principle, only the parent company has to pay CIT and TT. Nevertheless, the subsidiary (controlled entity) still qualifies as a taxable entity and has to file tax returns. One further tax benefit is that profit transfers of the subsidiary to the parent company are only taxed at the level of the parent company whereas, without a tax group, 5% of a dividend distribution would be subject to CIT and TT at the level of the parent company although the underlying profits were already taxed at the level of the subsidiary.

Moreover, the tax group allows for a debt push-down (see no. 7). Further benefits might be available (e.g. regarding the interest barrier rules, no trade tax addition for interest expenses, royalties or rental expenses).

An income tax group requires the following:

- The parent company must hold the majority of the voting rights in the subsidiary from the beginning of the subsidiary's fiscal year
- The parent company and the subsidiary must enter into a profit and loss transfer agreement for at least five entire years
- The agreement must be consistently carried out throughout the term of the agreement
- The subsidiary must be a corporation. The parent company can also be a trading partnership or sole trader
- The investment in the subsidiary must be functionally attributable to a German permanent establishment of the controlling entity and the income of the permanent establishment be subject to German tax and not be exempt under a DTT

**VAT group**

A VAT group is also possible under German tax law. This requires that the subsidiary is financially, economically and organisationally integrated into the parent company. Only the parent company is liable to VAT for transactions of the group. Unlike for a CIT and TT group, no profit and loss transfer agreement is required and the subsidiary does not have to file a tax return. However, the parent company itself has to be considered an entrepreneur (i.e. a taxable person) for VAT purposes; otherwise the VAT group is invalid.

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

Germany does not have a patent box or similar special tax status for companies that hold intangible assets. Also, Germany currently offers no R&D tax incentives with the mere exception of a prohibition to capitalise costs for self-created intangible fixed assets which as a consequence are immediately tax-deductible. According to the German coalition agreement published on 7 February 2018, however, the three governing parties (CDU, CSU and SPD) envisage introducing an R&D tax incentive for small and medium-sized entities.

In connection with action point 5 of the OECD's BEPS project, Germany unilaterally adopted an "anti-patent box". As of 2018, this license barrier restricts the tax deductibility of license fees or royalties paid by German taxpayers to related parties if at the recipient's level such payments are subject to low taxation (i.e. below 25%) based upon a preferential tax regime for intellectual property. In order to prevent avoidance structures, the license barrier also applies in "interposed cases" or licensing/sub-licensing structures, e.g. if a domestic licensee pays the license fees to an interposed company in a high-tax jurisdiction which passes on this income to a preferentially taxed company in a low-tax jurisdiction (instead of directly paying it to the latter entity). An exception applies for preferential tax regimes which – in line with the "nexus approach" described in BEPS action point 5 – require that the intellectual property was predominantly self-developed by the recipient of the license fees or royalties. If the requirements of the license barrier are met, the non-deductible portion of the license fees or royalties is calculated based on the assumed tax benefit of the recipient:

$$\frac{25\% - \text{recipient's effective tax rate}}{25\%}$$

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

The disposal of an intangible asset triggers an immediate realisation of profits from the transfer which are subject to (corporate) income tax and trade tax. If the transaction is carried out between related parties, the purchase price must comply with the arm's length price to be recognised for tax purposes. In practice, German tax authorities accept a purchase price/valuation of intangible assets which is in line with principles contained in the German Standard for Chartered Accountants S5 (IDW S 5). Based on these principles, a valuation of intangible assets (e.g. brands) should consider the future benefit that a potential purchaser will derive from using the asset in question. For instance, the income approach is preferred for the valuation of brands. It is based on future economic benefits derived from the use of a brand. Accordingly, the value of brands is determined by totaling the discounted future financial surpluses.

Where an intangible asset is allocated to a foreign permanent establishment of the same company with the result that the German right to tax that asset is excluded or limited, the allocation is deemed to occur at fair market value for (corporate) income tax and trade tax purposes. To that effect, any hidden reserves in such asset are immediately taxed even though they have not been realised in the market. Under certain conditions the taxation of such deemed profit can effectively be spread over a period of five years through setting up a tax adjustment item that subsequently is released by one-fifth in the fiscal year in which it was formed and the following four fiscal years. The formation of the tax adjustment item requires that the asset is transferred to a permanent establishment in another EU member state and that the transferor is subject to unlimited tax liability in Germany (i.e. a company with German tax residency that transfers the asset to its foreign permanent establishment but not vice versa).

If business functions and risks in conjunction with intangible assets are transferred to a foreign group entity or permanent establishment, the transfer generally qualifies as a taxable relocation of functions. As a consequence, the value of the "transfer package" as a whole has to be determined instead of the value of the individual assets. To that effect, not only the hidden reserves in intangible assets but also the earning potentials that are not substantiated in a manner concrete enough to qualify as an asset are subject to (corporate) income and trade tax based on a sound business valuation. As an exception from the overall valuation of the transfer package, an individual valuation is allowed if, for example, the taxpayer demonstrates that either no material assets and other advantages are included in the transfer package or at least one material – and precisely defined – asset is included in the transfer package. A taxable relocation of functions is not applicable in cases where a function is only duplicated across borders and the duplication does not lead to a limitation of the function performed locally. In practice, the triggering of immediate exit taxation can be avoided by licensing the transfer package.

# 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?

In principle, capital gains from the disposal of German assets (including partnership interests) are subject to German income taxation without any special treatment except for a potential tax-neutral roll-over regarding land, buildings or vessels if the corresponding proceeds are reinvested (see no. 21).

An important exception is the capital gain derived from the disposal of shares in a corporation by a corporation. Under German tax law, 95% of such a capital gain is in principle tax-exempt irrespective of any minimum shareholding or holding period. In the case of an individual person, the taxation of the capital gain from the disposal of shares depends on (i) the shareholding percentage, and (ii) whether the share is held as private property or as business property. For shareholdings of 1% or more, 40% of the capital gain is tax-exempt and 60% is taxable at the individual income rate (this ratio also applies to expenses in connection with the transaction). The same treatment applies (irrespective of the holding percentage) if the shares belong to a business or trade of

the individual. In all other cases a capital gain is taxed at a beneficial lump-sum tax rate of 26.375% (costs are not tax-deductible at all). If a partnership generates a capital gain from the disposal of shares, the applicable tax rule basically depends on the tax status of the partner (being a corporation or an individual person).

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

Under certain conditions, there are some tax advantages to reinvesting proceeds from an asset sale in cases where land, buildings or vessels are sold and new assets of such categories are (intended to be) acquired. The capital gain from the sale is not immediately subject to income taxation but can be deducted from the acquisition costs of newly acquired assets. As a result, the depreciation base of the newly acquired assets is reduced. If no new assets are to be immediately acquired, the capital gain can be parked tax-free as reserve and deducted from new acquisitions within the next four or, or in the case of new buildings, six years. However, if no new acquisitions take place in the relevant period of time, the reserve has to be dissolved, leading to a retroactive taxation of the release amount (increased by 6% p.a.). Individuals selling shares can benefit from rules similar to those described for real estate (applicable to capital gains of up to €500,000). There is no tax advantage to reinvesting sale proceeds from a share deal made by corporations.

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

Foreign holding companies need to prove certain substance requirements in order to benefit from WHT relief under a DTT or German tax rules (see nos. 10 and 14).

Holding companies do not qualify as entrepreneurs (i.e. taxable persons) for VAT purposes if they are mere financial holdings. In this case no (full) input VAT deduction would be available. A different VAT treatment would apply if a holding company carries out certain management services with regard to its subsidiaries for which it receives an arm's length remuneration.

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

German law provides for various forms of transferring assets, including mergers and spin-offs. The Reorganisation Act deals with many of these forms, including mergers and spin-offs. The Reorganisation Tax Act basically refers to the reorganisation forms of the Reorganisation Act. In general, mergers and spin-offs are considered as taxable events. However, under certain circumstances (see no. 15) mergers/spin-offs can be structured in a tax-neutral manner.

# MANAGEMENT INCENTIVES

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

Various types of management incentives are available in Germany including shares, sub-participations, stock options, phantom stocks and bonuses. The three most common schemes are shareholdings via a management partnership structure, exit bonuses, and direct shareholdings.

In the case of shareholdings, a manager's potential capital gain from a future exit in principle qualifies for the preferential capital gains tax rate of 26.4%. In practice, such equity participation is often implemented via a management partnership structure where the managers' shares are pooled in a specific investment vehicle in the legal form of a partnership (e.g. GmbH & Co. KG) whose general partner is regularly controlled by the investor. Alternatively, the shares can be held directly by the managers, which is structurally less complex but provides for no pooling element and only limited control by the investor.

An exit bonus is simple in structure. From the manager's perspective, however, an exit bonus actually received qualifies as employment income subject to the personal tax rate of up to 47.5%. At the same time the exit bonus is a tax-deductible business expense at the level of the employer.

No specific tax benefits exist for those schemes. In particular, within management equity participations the shares are regularly acquired at an arm's length price to prevent the receipt of shares from being treated as employment income. As the German tax authorities tend to reclassify the potential gains derived from management equity participations as employment income, it is vital that the scheme is structured in a way that the proceeds can be classified as capital gains.

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GREECE

# GREECE

## INTERNATIONAL DEVELOPMENTS

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

Within 2017 the applicable framework regarding domestic and EU cross border transfer of assets/spin offs has been amended. In line with the EU Merger Directive (Council Directive 2009/133/EC) 'transfer of assets' is 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 securities representing the capital of the company receiving the transfer. Based on the new rules, upon the transfer of assets the receiving company should not attribute to the contributed assets a taxable value greater than the value that they had in the transferring company prior to the transfer whereas the transferring company is entitled to attribute to the securities it receives their market value. The transferring company is permanently exempted from capital gains tax upon the subsequent transfer of the securities received unless relevant transfer takes place within the next three years following the transfer of the assets. In the latter case, for the purpose of computing the capital gains tax the value of the securities is equal to the value of the contributed assets immediately prior to the transfer.

Furthermore, tax administration issued within 2017 guidelines regarding the application of the legal framework for both domestic and cross-border mergers (Circular POL 1057/2017) introduced under the new Income Tax Code (new ITC) which are in line with the provisions of Merger Directive (2009/133) covering though both cross-border and purely domestic reorganizations. Following such guidelines local restructurings implemented under this regime have increased. Nevertheless, several issues, including valuation requirements, are still subject to contradictory views.

Moreover, the corporate framework applicable to corporate restructurings is anticipated to be amended within the year and to also cover partial divisions which although covered by the tax rules are not currently feasible due to the lack of corporate framework.

### 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?

Greece has participated in the discussions of the OECD BEPS actions and was a member of the ad-hoc Committee for drafting the Multilateral Instrument (BEPS Action 15).

Regarding BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, no specific action towards implementation have been taken yet. That said, Greece has historically not incorporated the limitation-on-benefits (LOB) clauses in its double taxation treaties, but has in some treaties included the principal purpose test (PPT) regarding specific types of income (i.e. interest, royalties). In this connection, reference should be made to Commission Recommendation of 28.1.2016 on the implementation of measures against treaty abuse, which recommends that, where a PPT based general anti-avoidance rule is included in tax treaties, in order to comply with CJEU jurisprudence, the PPT shall be modified compared to BEPS Action 6 to exclude from its scope situations which reflect a genuine economic activity.

The amendments introduced to the EU Parent-Subsidiary Directive by Directives 2014/86/EU and 2015/121/EU regarding adoption of an anti-hybrid rule and a special anti-abuse clause have been transposed in essence verbatim into domestic law. In particular, participation exemption for dividends received from qualifying EU companies shall only be granted to the extent that such profits are not deductible by the subsidiary. Furthermore, according to the anti-abuse clause, dividends participation exemption at parent company level and, where a Greek subsidiary distributes dividends, withholding tax exemption are not granted if an arrangement or series of arrangements exist which, having been put into place for (one of) the main purpose(s) of obtaining a tax

advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances, i.e. are not put into place for valid commercial reasons which reflect economic reality. Since dividends participation and withholding tax exemption apply as per domestic legislation also to purely domestic dividend distributions, the aforementioned restrictions apply similarly to such distributions.

Greece has since 2014 introduced in its domestic legislation provisions similar to those of the Anti-Tax Avoidance Directive ("ATAD"), namely:

- a GAAR provision
- CFC rules
- An interest limitation rule based on the company's EBITDA

There are no exit tax rules as per the ATAD. However with respect to business restructurings between related parties whereby intangible assets or a transfer package consisting of functions, assets, risks and business opportunities are being transferred, be it within or outside Greece, relevant transfers should be against an arm's length remuneration and any gain is taxable without the possibility of its payment in installments.

According to the Greek CFC rule, if a foreign entity is treated as a CFC, its total income is attributed to the Greek taxpayer, according to the percentage of such taxpayer's participation. A restriction of CFC taxation only to non-genuine arrangements applies only with respect to foreign companies established in the EU or an EEA jurisdiction with which exchange of information is in place. In deviation from the ATAD, a foreign entity is not treated as a CFC in either of the following cases:

- no more than 30% of net income before tax realized by the foreign entity qualifies as passive income, (e.g. dividends & capital gains, interest and other income from financial instruments, royalties, income from immovable property etc)
- no more than 50% of at least one type of passive income items stems from related party transactions.

## GENERAL

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

**A) Share deal**

**Tax advantages:**

Contrary to asset deals, no indirect taxes are due in connection with share deals. An exception applies to the transfer of listed shares (either on a Greek or overseas stock exchange), in which case the seller is liable to pay a 0.20% transfer tax on the sale value.

**Tax disadvantages:**

In the field of direct taxation gain from both share and assets deal are included in the selling company's corporate income and taxed at the ordinary corporate income tax rate currently at 29%. However, contrary to asset deals, the buyer is not entitled to depreciate the acquisition value of the shares and to deduct business expenses incurred for the acquisition of the shares.

**B) Asset deal**

**Tax advantages:**

In the field of direct taxation, as in the case of share deals, gains from the transfer of assets are included in the selling company's corporate income and taxed at the ordinary corporate income tax rate currently at of 29%. The buyer is entitled to deduct for corporate income tax purposes business expenses incurred for the acquisition of the assets and to perform depreciations on the assets acquisition costs.

**Tax disadvantages:**

Asset deals are subject to indirect taxes. Transfers of business as a going concern is subject to stamp duty at a 2.4% rate which is computed on the higher between the business net asset value or the consideration agreed. Stamp tax is in principle paid by the acquirer, but the parties may agree otherwise and is deductible for tax purposes. Transfers of single assets are in principle subject to VAT at 24%, which is recoverable. Moreover, the transfer of real estate is subject to real estate transfer tax at a rate of 3.09%.

## 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 step-up of value of the tangible and intangible assets of the target company may be achieved by the purchaser through internal restructuring that takes place following the purchase of the shares by means of a merger or division to be implemented with application of Greek tax incentive law 1297/1972. Based on relevant law, the assets of the entity being merged /divided are contributed at their market value and any capital gain is reported in tax free reserves to be taxed at the time the company is dissolved. Taxpayer is entitled to perform depreciations on the basis of the stepped up value that corresponds to the undepreciated value of the relevant assets at the time of the merger.

Moreover, in a spin-off carried out under the provisions of the new ITC, a step up is allowed at the level of the transferring company, as the latter shall valuate the shares in the receiving company at the market value of assets being spun-off without being taxed on the relevant gain, i.e. the difference between the book value and market value of spun-off assets. This applies provided that the transferring company does not dispose of such shares within three years from the spin-off and that it does not capitalize or distribute the relevant gain.

All above restructurings should meet the business purpose test otherwise the tax neutrality of the merger / other restructuring could be challenged.

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

Goodwill may be realised in the context of either a business assets acquisition as a going concern, or as an acquisition of separate intangible assets or a merger to take place following the acquisition of shares of the target company to be merged.

According to Greek GAAP, goodwill with indefinite useful economic life (UEL), is not subject to amortization but should be annually tested for impairment. In case the UEL cannot be reliably estimated, goodwill is amortized equally within ten years. Tax wise, goodwill realized in the context of both business asset acquisitions as going concern and as acquisition of separate intangible assets is amortized at a 10% rate annually. The same rules also apply for similar intangible assets (e.g. development costs, capitalized repair and maintenance costs etc.).

In cases of mergers, goodwill reflects the difference between the shares acquisition cost and the net asset value of the assets and liabilities of the merged company. If that difference is positive, it represents goodwill, which

should be recorded in a special account and be subject to amortization depending on its UEL. For tax purposes, based on past administrative guidance concerning mergers carried out under Law 2166 and an Administrative Supreme Court decision regarding mergers under Law 1297, the relevant amount should for tax purposes be treated as a non-deductible expense rather than goodwill; on this basis, it is likely that such amount would not be recognized as tax deductible, neither in the form of amortization nor as a one-off deductible expense, also in case the merger is performed under the provisions of the new ITC. If the difference is negative, it constitutes a gain from bargain purchase, which should be recorded as profit in the Income Statement of the respective consolidated accounts and be subject to corporate income 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?

In case of share deals and based on the guidelines of the Ministry of Finance interest on loans for the financing or the acquisition of the shares is not tax deductible. Relevant position does not seem to derive from the wording of the law while its correctness is questionable since capital gains to be earned upon the subsequent transfer of the shares will be fully taxable in the lack of a capital gains participation exemption regime in Greece.

Interests on the borrowings for the financing of the acquisition of business assets are deductible subject to the earning-stripping rules. In particular, net interest expense, if in excess of 3 million euros, is deductible provided that it does not exceed 30% of the company's EBITDA, EBITDA to be assessed under the Greek accounting principles following its readjustments for tax purposes. Net interest is defined as the amount by which interest expenses exceed interest revenues. Interest which exceeds the said thresholds may be carried forward indefinitely. Credit institutions, leasing and factoring companies are exempt from the scope of the earning-stripping rules.

Interest on related parties' loans is subject to transfer pricing rules whereas interest on third party loans, other than interest on loans by banks, inter-bank loans, as well as corporate bond loans, exceeding specific statistical thresholds set by the Bank of Greece is not deductible. There are also restrictions on the deductibility of interest payable to tax residents (individuals or legal entities) in non-cooperative or preferential tax regimes.

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

Debt push down has been achieved in the past through the merger of the entity holding the debt and the target/operational entity. Following the introduction of the new ITC effective as of 2014 and the limitation of the interest deduction on borrowing for financing the acquisition of shares it is uncertain whether relevant interest would be deductible if the entity holding the shares were to be merged with the target/operating entity. Moreover, the tax neutrality of a merger performed under the ITC provisions can be achieved only if the merger is carried out for valid commercial reasons. Therefore, debating views could be supported as to whether a merger to be implemented for the sole purpose of facilitating a debt push down could meet the business purpose test. Similar considerations should apply to mergers carried out under other incentives laws for domestic reorganization, based on the GAAR introduced as of 2014.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Equity financing of newly incorporated entities is exempt from capital accumulation tax at 1%. Relevant exemption was introduced back in 2014 as an incentive for stimulating the set-up of newly formed companies.

Any additional capital injection by means of a share capital increase is subject to capital accumulation tax at 1%. In addition, payment of share capital into a Société Anonyme is subject to a duty of 0.1% payable to the Greek Competition Committee.

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

Under the general rules, losses are carried forward for a period of five years. No carry back is available.

In cases of change of control as well as in case of a transfer of a participation exceeding 33% in value or number, the right to carry forward tax losses ceases to apply, unless the taxpayer proves that the transfer was effected exclusively for commercial or business reasons and not for the purpose of tax avoidance or tax evasion.

In the context of a merger the losses carry forward right of the transferring company (i.e. the company being absorbed) is lost. Exceptionally, if the merger is implemented according to the provisions of the ITC (which in general introduced provisions similar to those of the Merger Directive, also for purely domestic restructurings), tax losses of the transferring company survive the merger, provided the restructuring is carried out for valid commercial reasons.

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

Particular attention should be paid to the years which a tax due diligence should cover, since consecutive extensions of the statute of limitations ("SOL") have taken place since 2006, whereas different regimes concerning SOL apply to years before 2013, according to the previously applicable ITC, and after 2014 when the new ITC came into force. Based on recent guidelines of the Independent Authority for Public Revenue, which are in line with recent jurisprudence of the Administrative Supreme Court, fiscal years up to 2011 and earlier, or in case of additional evidence fiscal years 2006 or earlier, should generally have been subject to prescription for income tax purposes based on SOL. Different SOL rules apply with respect to property taxes, indirect taxes, gift and inheritance taxes.

Moreover, there are special rules for tax recognitions of bad debt provisions and write-offs or "haircuts.

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

Acquisitions of shares are exempt from VAT and stamp tax.

A 0.20% transfer tax applies on sales of shares listed on the Athens Stock Exchange, which burdens the seller of the shares (See above under question 3.).

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

Based on ministerial guidelines on the provisions of the new ITC, shares acquisition costs including financing costs are not deductible given that dividend income is tax exempt (see also above under question 6).

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

In case of shares deals, VAT on acquisition costs, e.g. professional fees, is recoverable provided that the taxpayer engages in an economic activity and the relevant costs relate to such economic activity and not to a passive investment activity.

VAT paid on the value of the single assets is recoverable under the generally applicable rules.

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

Dividends distributed by Greek companies are subject to dividends withholding tax which is currently 15%. Relevant withholding tax can be reduced or eliminated in case of distributions to foreign residents qualifying under the applicable Double Tax Conventions and/or the EU Parent Subsidiary Directive. In particular, no tax is imposed if the receiving EU parent company has a minimum 10% shareholding participation in a Greek company for an uninterrupted two-year period and has a legal form qualifying for application of the Parent-Subsidiary Directive. On the other hand, there is no profit withholding tax upon the remittance of profits from the permanent establishment to the head office.

In terms of exiting a Greek holding structure, foreign companies disposing their shares in Greek companies are not subject to Greek corporate income tax on their gain, provided that the shares were not held through a Greek permanent establishment of such foreign companies. Therefore, share deals work more efficiently from a tax perspective for foreign tax resident sellers.

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

There are several frameworks for achieving a tax-neutral restructuring in Greece. Greek laws providing for a tax neutral restructuring are the Greek tax incentive laws (i.e. 2166/1993 or 1297/1972), law 2578/1998 on cross-border mergers among EU entities and the new ITC, transposing the EU Merger Directive into national legislation and applicable to both EU and domestic restructurings. Available options are mergers, spin-offs, contributions of businesses or business sectors, share exchanges and changes in the legal form of the company.

The requirements, procedure (requirement for prior valuation, implementation at book or fair market values), and impact (e.g. entitlement to carry forward tax losses, restrictions upon future sale of assets, legal and economic effects of the merger) vary depending on the legal framework to apply. Therefore, an analysis is to be made prior to opting for the tax framework to apply in each merger taking into account the background of the companies involved.

From a practical perspective, the new ITC has been extensively used for recent business restructurings. This is because, contrary to other applicable laws, the restructuring provisions of the new ITC allow under conditions for the carry forward of tax losses of the restructured (i.e. absorbed etc.) entity.

The most straight forward and commonly used tax incentive law is Law 2166/1993 which is implemented at book values while its economic effects apply retroactively from the commencement of the merger procedure, i.e. from the transformation balance sheet date.

On the other hand, in case it is intended for the entity being restructured to step up the value of its assets, then Law 1297/1972 is usually the most tax efficient option, which however requires a prior valuation of the assets and liabilities of the entity being restructured and therefore renders the process more time consuming. The tax exemptions granted by means of Law 1297/1972 are to be revoked in case that (a) the company is dissolved prior to the lapse of five years following the merger, unless such dissolution results from certain forms of reorganizations and (b) the real estate property of the company is disposed of within five years following the merger unless the proceeds from the sale are used to finance qualifying payments.

Although only the ITC provides for a special anti-abuse provision requiring that the restructuring be performed for valid commercial or business reasons, Greek tax administration has recently scrutinized reorganizations performed under the other applicable frameworks from an anti-abuse perspective (see also answer in question 7).

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

Eligibility for the exemption from the Special Real Estate Tax ("SRET") should be reviewed both from the acquirer and from the target entity perspective. SRET is a property tax that applies to companies holding Greek real estate on January 1st of each year unless such companies are entitled to apply one of the available exemptions. The tax is computed at a 15% rate on the statutory value of the immovable property. Special due diligence should be performed to review the compliance of the target entity with the respective property tax and the proper collection of the supporting documentation required for the purpose of validly claiming an exemption, which sometimes has been proved difficult to collect. Exemptions are applicable among others to companies that generate in Greece higher amounts of business income than rental income, to listed companies and other regulated entities as well as to entities disclosing the details of their ultimate shareholders, who need to have obtained a Greek tax identification number.

Real estate companies equally qualify for the application of Greek tax incentive laws (i.e. Laws 2166/1993 and 1297/1972) and the provisions transposing the EU Merger Directive into domestic legislation (i.e. Law 2578/1998 and the restructuring provisions of the new ITC, which also apply to purely domestic restructurings). Therefore, it is possible to reorganize real estate companies e.g. by way of merger without triggering capital gains and real estate transfer taxes.

Restrictions on the subsequent transfer of real estate assets apply in cases of tax-neutral mergers under tax incentives law 1297/1972 as stated above (see question 15).

Finally, the new Greek ITC introduced a specific provision for real estate rich companies, i.e. companies deriving more than 50% of their value from real estate. Based on relevant provision capital gains from the transfer of shares of real estate rich companies are treated similarly to the capital gains from the transfer of the real estate. Relevant provision that entered into force on January 1st 2014 has been under suspension from January 1st 2015 and up until 31.12.2018 and thus no guidelines regarding its application exist so far.

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

No tax grouping is allowed in Greece.

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

No patent box regime is provided in Greece. However, instruments and equipment used for research and development which are specified in a Ministerial Decision may be amortized at a 40% rate annually. Moreover, R&D expenses including amortization of instruments and equipment used for R&D are subject to a 130% super-deduction under specific requirements.

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

In business restructurings between related parties whereby intangible assets or a package consisting of functions, assets, risks and business opportunities are being transferred, be it within or outside Greece, relevant transfers should be against an arm's length remuneration and any gain is taxable without the possibility of its payment in installments (see also question 3).

## 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 (or losses) are generally regarded as ordinary business income (or losses) and are treated accordingly for tax purposes. No capital gains participation exemption exists. However, no corporate income tax is levied on the capital gain where the transferor is a foreign company and the capital gain (loss) is not attributable to a permanent establishment thereof in Greece, since corporate entities are currently taxed for the income generated through a permanent establishment in Greece.

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

No specific advantage exists if the transaction price of the sale of the shares is reinvested by the seller company.

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

There are no local substance requirements per se from a tax perspective for holding companies established outside Greece.

A legal entity is considered as a Greek tax resident according to domestic tax residence rules and thus is subject to Greek corporate income tax on its worldwide income if it is incorporated, seated or effectively managed at any time of the year in Greece. Effective management is perceived as being exercised in Greece taking into account i.e. the place of:

- exercise of day-to-day business
- strategic decision-making
- annual shareholders' meetings
- bookkeeping
- BoD minutes
- residence of BoD members
- residence of the majority of shareholders may potentially also be considered along with the above mentioned factors

Furthermore, Greece has transposed the Parent-Subsidiary Directive GAAR and has CFC rules in place, which both require a minimum substance. In the context of CFC rules such minimum substance has been specified as including e.g. the foreign company having physical premises, permanent payroll, being tax resident in the country of its establishment and being subject to tax in such jurisdiction.

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

Regarding direct tax treatment, please refer above to question 15.

As regards indirect taxes:

Mergers and spin-offs fall outside the scope of VAT, provided that both the transferring company and the receiving company are subject to VAT, act under such capacity and the receiving company continues the business activity of the transferring company. According to a recent Legal Council of State opinion, this applies regardless of whether the liabilities of the transferring company are transferred along with its assets, while it also applies when the transferring company is under special liquidation.

Based on the generally applicable rules, mergers and spin-offs involving the transfer of assets and liabilities in exchange for shares are not subject to stamp tax.

In mergers and spin-offs performed under the regimes of Law 1297, Law 2166 and the restructuring provisions of the new ITC, no stamp tax or other taxes are imposed in respect of the merger/spin-off agreement, the contribution or transfer of assets and liabilities or other rights and obligations under the merger, corporate resolutions of the companies under merger, the participation in the share capital of the receiving company and any other agreements or acts required for the consummation of the mergers/spin offs. Similar broad exemptions also apply under the regime of article 16 of Law 2515, which explicitly refers to an exemption of the articles of association and the shares issued by the receiving credit institution.

Capital accumulation tax of 1% is in principle due on capital accumulations (i.e. conversion or merger of a company, capital increase or contributions of assets to the share capital). However, according to ministerial guidelines as regards mergers effected under the regimes of Law 1297 and Law 2166, this tax is effectively levied only to the extent that the receiving company's capital is increased by new contributions, other than those reflecting the share capital of companies already subject to capital accumulation tax (e.g. so as to meet several minimum share capital requirements imposed by company law and/or tax incentive law provisions) and other than the part of the capital reflecting any surplus values arising under an evaluation of assets, where applicable. According to guidelines on reorganizations performed under the new ITC, if the reorganization results in the creation of a new entity, the exemption from capital accumulation tax regarding payment of initial share capital applies.

Cash or in-kind contributions of assets to Sociétés Anonymes by means of share capital increase are in principle subject to a duty of 0.1% payable to the Greek Competition Committee. However, the said duty is not applicable to transactions effected under one of the tax incentive regimes for reorganization.

Mergers and spin offs implemented under Law 1297, Law 2166 and the restructuring provisions of the new ITC with respect to qualifying reorganizations are also exempt from real estate transfer tax (RETT). If no such laws apply, any transfer through a merger operation of rights in real estate property is subject RETT at 1.545%, whereas respective transfers through a spin off are subject to RETT at 3.09%. RETT is computed on the higher of the transfer price and the objective value i.e. the value imputed for tax purposes on the basis of statutory rules (applicable to almost the entire territory of Greece) taking into account parameters such as area, age etc.), is borne by the receiving company and is deductible for corporate income tax purposes. In mergers and spin-offs performed under Law 2166 or the new ITC as well as, under conditions, Law 1297, transfers of real estate property are exempt from RETT.

## MANAGEMENT INCENTIVES

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

No specific management incentives are available from a tax perspective in Greece in connection with selling or buying a company.

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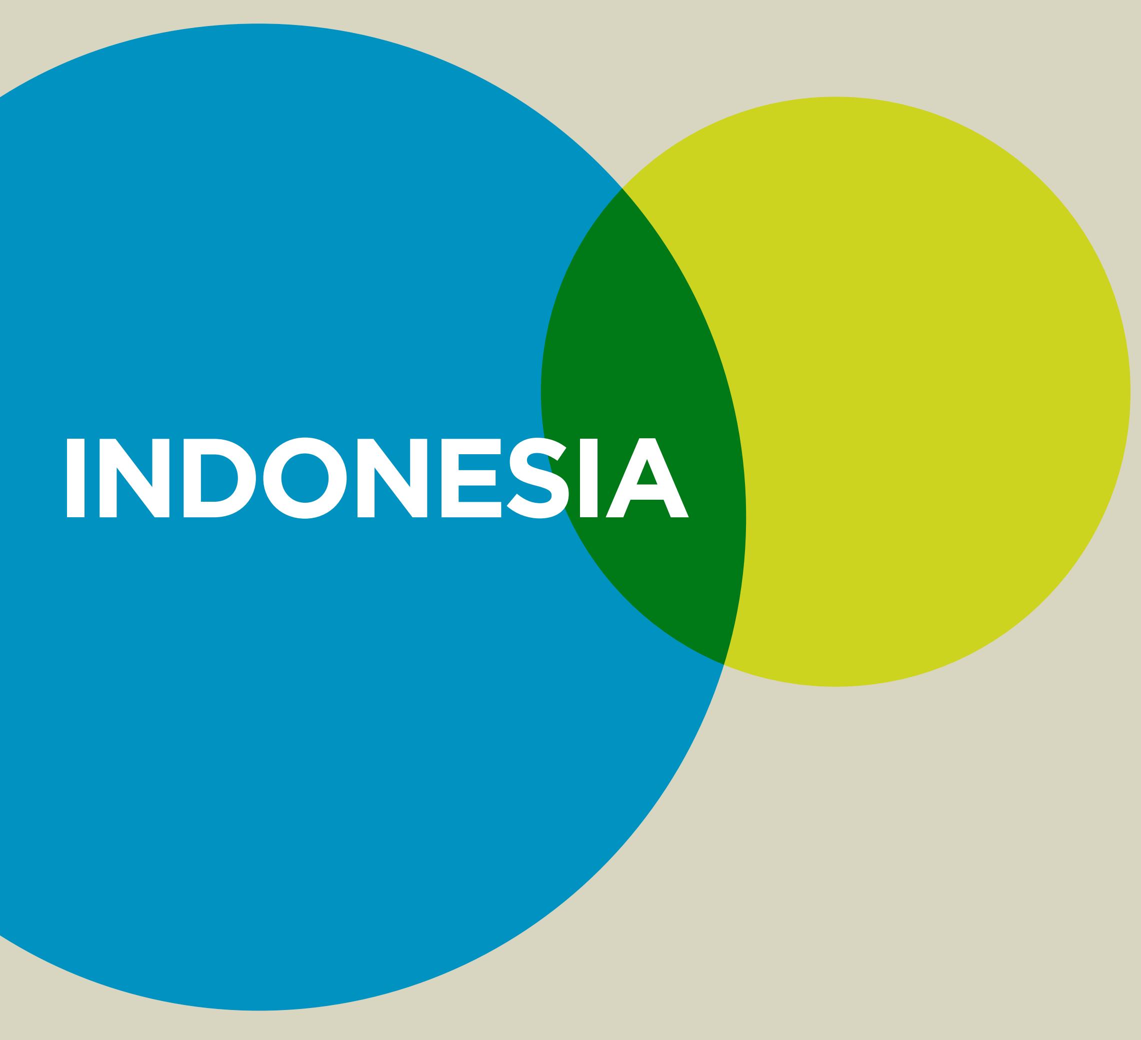

# INDONESIA

# INDONESIA

## INTERNATIONAL DEVELOPMENTS

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

In 2017, the Minister of Finance issued Regulation No. 52/PMK.01/2017 regarding The Use of Book Value for Transfer of Assets in the context of mergers, consolidations, expansions or acquisitions, which enables companies to conduct mergers using book value (tax neutral merger).

The following conditions shall be applied to two or more companies that conduct tax neutral mergers:

- There is no capital gain incurred from the transfer of assets in the context of tax neutral merger.
- Land and/or building value, which is transferred by the dissolving entity to the surviving entity, is subject to Article 4 paragraph (2) final income tax at the rate of 2.5% of the transaction price or Tax Object Sales Value (NJOP), whichever is higher.

  Meanwhile, the surviving entity should pay a 5% Duty on the Acquisition of Land and/or Building Right (BPHTB) from the transaction price or Tax Object Sales Value (NJOP), whichever is higher after deducting Non-Taxable Value of Tax Object Acquisition/NPOPTKP (maximum of IDR 60 million). The surviving entity may request a 50% reduction on this duty from the regional government. This reduction may be applied if the company has received a decision from the tax authority to conduct a tax neutral merger.

  No Value Added Tax (VAT) is imposed due to the transfer of assets provided that both the dissolving and surviving entities are registered as Taxable Entrepreneurs.

  A business acquisition is specifically defined in the regulation as including a merger of a Permanent Establishment ("PE") of a bank with a domestic corporate taxpayer whose capital is divided in the form of shares by way of transferring all assets and liabilities of the PE to the domestic corporate taxpayer, in which the PE is dissolved.

### 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?

Upon the issuance of Director General of Taxes Regulation No. PER-10/PJ/2017 dated June 19, 2017 on the Procedures for the Implementation of the Double Taxation Agreements (DTA); the procedures for applying DTA no longer follow the previous provisions of DGT Regulations No. PER-61/PJ./2009, PER-62/ PJ./2009, PER-24/ PJ./2010 and PER-25/PJ./2010, as these have now been revoked.

As stipulated in the Article 10 of the regulation, the term Beneficial Owner (BO) refers to an entity that is not acting as an agent, nominee or conduit; that has controlling rights or disposal rights on the income or the assets or rights that generate the income; where no more than 50% of the entity's income is used to satisfy claims by other persons;  the entity bears the risk on its own assets, capital or liability.

Abuse of the DTA is considered to have occurred, amongst others, if there was a difference between the legal form of a structure/scheme and its economic substance (economic substance). In addition to the conditions above, the misuse of the DTA is also considered to occur if the overseas taxpayer has no activity or active businesses besides receiving income in the form of dividends, interest and or royalty, which originate from Indonesia.

Foreign Taxpayers have to provide a Certificate of Domicile of Non-Residents for Indonesian Withholding Tax, namely Form-DGT 1 (both page 1 and page 2) or Form-DGT 2 (for financial institution), a form used by the Indonesian Tax Office to confirm that the recipient is the Beneficial Owner and the transaction does not aim to

abuse a tax treaty. In PER-10/PJ/2017, it is stipulated that the said Certificate of Domicile shall be reported in the withholding taxpayer's periodic income tax return for the tax payable period (month). If the Certificate of Domicile is not yet available at the time income tax is payable or before the submission deadline of the periodic income tax return (every 20th of the following month), then the taxpayer should use the tariff of income tax according to Article 26 of the Income Tax Law (without regard to the treaty). If the new Certificate of Domicile is available after the withholding of income tax, then the excess withholding may be refunded.

The mechanics for the refund of incorrect reduction or overpayment related to the application of a DTA by overseas taxpayers, may be made pursuant to the Minister of Finance Regulation No.187/PMK.03/2015 or through the Mutual Agreement Procedure (MAP) through the respective treaty partner's authority, if the withholding taxpayer does not submit the periodic tax return or if there is a tax dispute between the authorities of the treaty partners.

## GENERAL

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

In Indonesia, the main differences between acquisitions made through a share deal versus an asset deal are as follows:

**A) Share deal**

- Capital gain received by the entity in a share deal is subject to a corporate income tax of 25%, while capital gain received by an individual is subject to an individual income tax at the range of 5% to 30%
- Since shares are categorised as non-taxable goods, there is no VAT applicable in share deals

**B) Asset deal**

- Capital gain received by the entity in an asset deal is subject to a corporate income tax of 25%, while capital gain received by an individual is subject to an individual income tax at the range of 5% to 30%
- Generally, a 10% VAT is imposed on the transfer of moveable assets. However, this condition does not apply to:
  - **a.** the transfer of non-taxable assets (i.e. mining products, public essential commodities, foods and beverages, gold and commercial paper)
  - **b.** the transfer of assets that have no relation with the company business

**Immovable Assets (land and/or building)**

- For the seller, the transfer of immovable assets is subject to a final income tax of 2.5% of market value or Tax Object Sales Value (NJOP) of the assets, whichever is higher (applicable to individuals and corporations).
- For the buyer, the acquisition of immovable assets is subject to a 5% Duty on Acquisition of Land and Building Right (BPHTB) applied to the transaction price or Tax Object Sales Value (NJOP), whichever is higher after deducting the Non-Taxable Value of Tax Object Acquisition/NPOPTKP (maximum of IDR 60 million).

Generally, a 10% VAT is imposed on the transfer of immovable assets. However, this condition does not apply to immovable assets that have no relation with the company's business.

## 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?

In principle, there are no special provisions in the Indonesian income tax law to step up the value of the tangible and intangible assets in case of share deals.

Asset revaluation is usually utilised by companies that need financing, so that the respective companies will have “more” assets to be used as collateral for bank loans. This is also a strategy to step up the value of tangible assets. Subject to Director General of Tax approval, an Indonesian taxpayer may undertake a revaluation of its non-current tangible assets for tax purposes. This may be carried out once every five years. Prior to receiving DGT approval, the taxpayer must have settled all outstanding tax liabilities.

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

Amortisation of goodwill, which has a useful life exceeding one year, may be proportionally treated as expense during 4 years, 8 years, 16 years, or 20 years using the straight line or double declining balance method.

### 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?

There are limitations to the deductibility of interest on borrowings. The limitations were first set out in the regulation from Minister of Finance No. 169/PMK.010/2015 regarding Thin Capitalisation. It was stated in the regulation that Indonesian corporate taxpayers are required to maintain a Debt to Equity Ratio (DER) at no more than 4:1 for tax purposes. On 28 November 2017, the Directorate General of Tax issued Regulation No. PER-25/PJ/2017, and introduced the DER forms consisting of two main forms, i.e. the DER and foreign private debt forms.

In terms of the Debt to Equity provisions, to be able to fully claim the financing cost, the loan amount is limited to four times the equity amount. Furthermore, corporate taxpayers have to be aware of the arm’s length principle if the loan is treated as an inter-company loan.

In the event that a taxpayer’s debt to equity ratio exceeds 4:1, the interest expense that can be deducted in calculating taxable income shall be limited in accordance with the debt to equity ratio of 4:1.

Please note that in the event that a taxpayer has zero or less balance of equity, the taxpayer’s entire interest expense is non-deductible in calculating the taxable income.

Banks, financing institutions, insurance and reinsurance taxpayers, and taxpayers that carry out businesses in the mining and infrastructure fields are excluded from the provisions on the debt to equity ratio.

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

There are no usual strategies to push-down the debt on acquisitions. However, complex tax issues such as transfer pricing, VAT, capital gains and interest deductibility should be considered prior to the implementation.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

As stipulated in the regulation of the Directorate General of Tax No. Per-25/PJ/2017, the following financing costs are not deductible:

- The part of the financing costs that exceeds the maximum DER ratio
- The part of the related party financing costs that fails to conform with the arm's length principle
- Financing costs to obtain, collect and maintain non-taxable income
- Financing costs to obtain, collect and maintain income subject to final tax

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

The losses of the target company are available for a five-year carry-forward. The tax authority might make an adjustment on the fiscal losses based on the tax audit process.

However, in context of a tax neutral merger, the losses of the target company are not available after the effective date of merger.

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

There are no specific items to be included in the scope of a tax due diligence.

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

Securities or documents with any name or in any form whatsoever (including shares), which have nominal values of up to IDR250,000 shall not be subject to Stamp Duty. If the value is above IDR250,000 and up to IDR1,000,000, the securities or documents shall be subject to Stamp Duty at the tariff of IDR3,000, while those with nominal value of more than IDR1,000,000 shall be subject to Stamp Duty at the tariff of IDR6,000.

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

Acquisition costs shall be the value of shares or assets and additional costs related to the acquisition, such as advisory fees from the corporate finance advisor and/or legal fees.

The value of shares or asset shall be recorded as assets.

There are no specific tax regulations that set forth the tax treatment for additional costs related to shares or asset acquisition. Therefore, it shall comply with the treatment of the prevailing Indonesian Financial Accounting Standard (PSAK).

- **Acquisition of Shares**

  In case of a share deal, there are no restrictions on the deductibility of additional costs. The additional costs shall be treated as expense in the year of the acquisition (PSAK 22).

- **Acquisition of Assets**

  The additional cost for asset acquisition, which have a useful life exceeding 1 year, shall be capitalised and shall be depreciated over its useful life (PSAK 16). The depreciation may be treated as expenses proportionally over the duration of 4 years, 8 years, 16 years, or 20 years, using the straight line or double declining balance method.

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

Generally, VAT input from an asset acquisition may be compensated with VAT output in the following fiscal period or be claimed as a tax refund at the end of the fiscal year. There is no VAT input for a share acquisition.

However, VAT input for assets categorised as non-capital goods acquired by a company that has not yet delivered taxable goods or services cannot be compensated with VAT output in the following fiscal period or be claimed as tax refund at the end of fiscal year.

The VAT input from the additional costs related to the shares or asset acquisition can be compensated with VAT output in the following fiscal period or be claimed as a tax refund at the end of the fiscal year

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

- Asset Deals

Foreign companies are not allowed to directly acquire land and/or buildings in Indonesia.

- Share Deals

The prevailing Indonesian law (President Regulation No. 44 of 2016), regulates the percentage of foreign ownership allowed for different types of businesses in certain sectors.

In general, all types of businesses are open to foreign investment, except certain closed types of businesses and limitations of maximum ownership in several industries

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

Yes, the group is allowed to reorganise after the acquisition in a tax neutral environment through mergers.

To apply for a tax neutral merger, certain conditions must be satisfied. The conditions are the following:

- submitting an application using the book value for the merger to the Director General of Taxes, along with the justification and purpose of the merger,
- paying all tax payable from every related entity, and
- satisfying the requirements of the business purpose test.

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

VAT input for a company that purchases real estate as its inventory cannot be credited in cases in which the company has not yet sold or delivered taxable goods or services to other parties.

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

There is no fiscal unity/tax grouping under Indonesian tax law.

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

There are no special tax statuses such as patent box for companies that hold intangible assets.

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

There are no adverse tax consequences for the time being if the ownership of the intangibles is transferred out of the country.

## 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 gain must be combined with the company's revenue from its main business after deducting expenses. The net profit is subject to a 25% corporate income tax. For individuals, capital gain after it is combined with their income shall be subject to individual income tax within the range of 5% until 30%.

There is no participation exemption regime available in Indonesia.

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

There is no fiscal advantage if the proceeds from the sale are reinvested.

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

The prevailing Indonesian law (President Regulation No. 39 of 2014) regulates the limitation of foreign ownership for finance companies. Meanwhile, the limitation of foreign ownership of a holding company in Indonesia depends on the type of industries of the operating companies under the holding company.

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

There are no special tax considerations regarding mergers/spin-offs. However, a registration with the Investment Coordinating Board in the framework of the Initial Public Offering must become effective within one year for the taxpayer who applied for spin-offs using the book value.

## MANAGEMENT INCENTIVES

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

There are no specific tax considerations for management incentives. However, any remuneration received by an individual is subject to individual tax.

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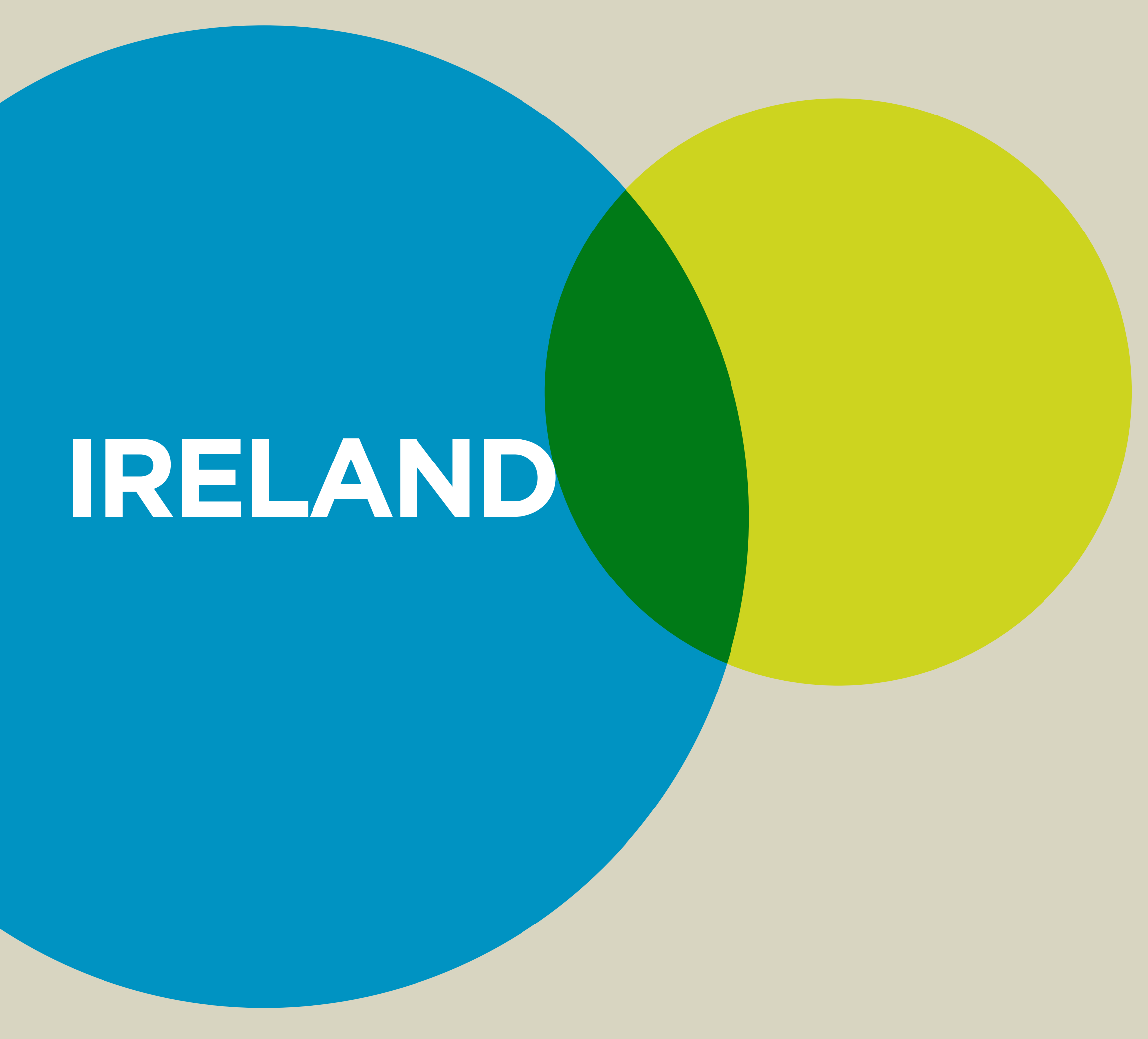
IRELAND

# IRELAND

## INTERNATIONAL DEVELOPMENTS

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

A reduced rate of capital gains tax ("CGT") has been introduced for entrepreneurs and the self-employed with effect from 1 January 2016. Finance Act 2017 lowered the reduced rate to 10% (as opposed to the standard CGT rate of 33%). The reduced CGT rate will apply to the disposal in whole or in part of a trade or business up to a maximum lifetime limit of €1 million of net chargeable gains. The relief will be available to the individual owners of a trade or business on the disposal of all or part of that trade or business. The individual must have owned the chargeable business assets for a continuous period of 3 years in the 5 years immediately prior to the disposal of the assets. Relief will apply to the disposal of shares in a private company provided the individual owned at least 5% of the shares in the company (or 5% of the shares in a holding company which holds 51% of the shares) and was a full time working director for at least three years before the sale. Relief will not apply to disposals of the following assets:

- shares, securities or other assets held as investments
- development land
- assets on the disposal of which no chargeable gain would arise
- assets personally owned outside a company, even where such assets are used by the company

Additional anti-avoidance measures were introduced in Finance Act 2017. These changes provide that the relief will not be granted where:

- goodwill or shares/securities are disposed of to a company with which the individual is connected immediately following the disposal; or
- incorporation tax relief has already been granted on the transfer of business assets to a company.

However, these new anti-avoidance measures do not apply in situations where a disposal is made for bona fide commercial reasons and is not part of a tax avoidance arrangement. A general anti avoidance measure has also been included to ensure that the relief will not apply where the steps are taken to ensure that an individual is artificially unconnected with a company for the purposes of avoiding tax.

There have been a number of anti-avoidance measures introduced in recent years. Of particular relevance to M&A deals are provisions designed to counteract schemes which were used to avoid a CGT charge on the sale of Irish shares which derived the greater part of their value from certain Irish "specified assets" (broadly Irish land or buildings, minerals or mineral rights and certain exploration rights). Such schemes involved transferring cash or other assets to the company prior to the sale to ensure that the shares derived their value from cash rather than Irish specified assets, to avoid a charge to Irish CGT. Amendments made by Finance Act 2015 and Finance Act 2017 ensure that any cash or other non-specified assets will not be taken into account in determining how the shares derive their value.

### 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?

In general Ireland's tax legislation already covers many of the areas which the BEPS project has focused on e.g. anti-avoidance and mandatory disclosure. In addition, Ireland has introduced a number of measures with a strong focus on BEPS compliance, including Country-by-Country reporting. Ireland has signed up to the Multilateral

Competent Authority Agreement for the automatic exchange of Country-by-Country reports. Ireland has also launched a consultation process on Ireland's Corporation Tax Code with a view to bringing certainty to the implementation of the remaining BEPS recommendations.

Ireland was one of the countries which participated in the development of the Multilateral Instrument pursuant to Action 15. Ireland signed the Multilateral Instrument on 7 June 2017. It must now be ratified into Irish law by the Irish legislature. This will enable Ireland to update 71 of its 72 tax treaties currently in effect as covered tax agreements (CTAs) under the MLI (Ireland's treaty with the Netherlands is the exception and is currently under renegotiation). Ireland will adopt a Principal Purpose Test instead of a Limitation of Benefits clause to prevent treaty abuse. Ireland will also adopt the new best practice rule in Article 4 on determining tax residence for dual resident entities. However, Ireland will opt out of Article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions) and Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents) in Action Plan 6.

The Irish law implementing the EU Parent Subsidiary Directive was amended in Finance Act 2015 to introduce broader anti-avoidance measures. These changes ensure that the reliefs provided for under the PSD will not apply where arrangements are in place which are not genuine, and where the main purpose, or one of the main purposes of such arrangements is to obtain a tax advantage which defeats the objective of the PSD.

Ireland is a strong supporter of the Second Anti-Tax Avoidance Directive and aims to implement the changes within the transposition period.

## GENERAL

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

### BUYER'S PERSPECTIVE

#### Stamp duty

In general, the stamp duty on the transfer of shares is 1% of the consideration paid or of the market value if higher. However, provided certain conditions are complied with, an exemption from stamp duty is available on the sale of shares where the amount or value of the consideration is €1,000 or less. In certain cases, where the shares derive their value or the greater part of their value from Irish non-residential land or buildings, the rate of stamp duty may rise to 6% (see section 16 for further detail).

For asset deals, the stamp duty rate is 6% of the consideration paid or of the market value if higher. There is an exemption on the sale or transfer of certain intellectual property such as patents and trademarks. Where assets are capable of being transferred by delivery and are transferred by delivery and not pursuant to any written instrument, then no stamp duty applies.

#### VAT

The purchase of shares is a VAT-exempt activity. Therefore, a company which incurs costs in relation to the acquisition of shares in a newly acquired entity is not generally entitled to recover the VAT on such costs.

However, there are specific circumstances where the Irish Revenue Commissioners ("Revenue") accept that a company which has acquired shares can recover a portion of the VAT incurred on such costs. See section 11 below for further detail.

Generally, the transfer of assets is subject to VAT. However, where the assets transferred constitute a business or part of a business capable of being operated on an independent basis, the transfer is deemed not to be a supply for VAT purposes. This exemption applies to the transfer of tangible and intangible assets. It also applies even if the business has ceased trading.

### Base cost and deferred gain

In an asset deal the purchaser's base cost in the assets will be the price paid for the assets. This will be relevant for any future sale of the assets.

In a share deal the purchaser's base cost is represented in the shares acquired. To the extent that the target company owns assets which have a base cost of less than their current market value, a deferred or latent gain exists. Such a deferred gain is often taken into account by purchasers in deciding on the price for the shares. However, since the stamp duty is less on a share sale than on an asset sale (save where the shares derive their value from non-residential land and buildings), this may also be taken into account in the pricing.

## SELLER'S PERSPECTIVE

### Double taxation

The sale of assets in a company will typically result in two layers of taxation, and corporation tax will be payable by the company in respect of any chargeable gains or balancing charges triggered on the sale of the target assets. CGT or income tax or corporation tax will also be payable in the hands of the ultimate shareholders, depending on whether the proceeds from the sale are distributed upon a subsequent liquidation of the company or as a dividend. In contrast, the sale of shares avoids double taxation on the extraction of the sale proceeds. Share sales typically only trigger a single layer of taxation — either CGT or corporation tax in the hands of the selling shareholder. In addition, in certain circumstances where a company disposes of shares it will be exempt from CGT under the participation exemption regime (see section 15 below).

### Losses

In a share sale, where a target company has losses, it may be possible for the losses to be used going forward (see section 8 below). However, in an asset sale, it is not possible to purchase losses.

### VAT recoverability

Generally, the transfer of assets is subject to VAT. However, depending on the VAT status of the seller and purchaser, where the assets transferred constitute a business or part of a business capable of being operated on an independent basis, the transfer is not deemed to be a supply for VAT purposes. This applies to transfers of tangible and intangible assets and applies even if the business has ceased trading.

There are provisions under Irish VAT legislation which may allow a company to recover VAT incurred on costs associated with the transfer of a business or part of a business.

The transfer of shares is VAT-exempt under Irish VAT legislation. Therefore, where costs (e.g. professional fees) are incurred by a vendor and those costs have a direct and immediate link to the sale of the shares, the VAT on such costs is generally irrecoverable under Irish legislation (apart from transactions involving non-EU clients (i.e. qualifying activities)).

EU case law suggests that VAT on costs incurred in a disposal of shares may in certain circumstances be recoverable where a holding company disposes of shares in a subsidiary to which it has supplied management services.

### Exiting a group

If a company leaves a group as a result of a sale of shares, a CGT charge may arise where an asset has been acquired from a group member within the previous ten years.

### Anti-avoidance

Anti-avoidance legislation provides that, where dividends or distributions are made in connection with the disposal of shares in a company, these can be taxable as part of the proceeds of the disposal of the shares. This provision applies where the amount of the dividends paid to a company is more than would reasonably be expected to be made if there were no disposal of the shares.

## 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?

In share deals in Ireland, no step-up in value of any assets of the target company is possible.

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

No specific tax depreciation is available for goodwill in Ireland. However, tax relief is available in Ireland on capital expenditure incurred by companies on the acquisition of intangible assets, including goodwill which is directly attributable to these intangible assets.

The definition of an "intangible asset" which qualifies for this relief is very wide and includes patents, trademarks, brand names, domain names, any copyright, computer software, know-how generally related to manufacturing or processing and customer lists (except where such customer lists have been provided directly or indirectly in connection with the transfer of a business as a going concern).

The relief is designed to provide tax allowances broadly equal to the write-off to the profit and loss account available under normal accounting rules for capital expenditure incurred on the provision of specified intangible assets.

Under the relief, the capital expenditure incurred to acquire intellectual property can be written off either in line with the accounting write-off or over a 15-year period. If a company makes this election, a rate of 7% will apply for years 1 to 14 and of 2% for year 15. Certain claw back provisions may apply if the asset is disposed of within 5 years of acquisition.

However, Finance Act 2017 introduces a cap on the amount of capital allowances that can be deducted for intangible assets. The cap restricts the deduction for capital allowances to 80% of the trading income derived from those intangible assets. This cap applies to expenditure incurred on or after 11 October 2017.

### 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?

In considering whether any limitations apply to the deductibility of interest on borrowing, it is necessary to look at the various bases upon which a deduction can be claimed:

**Tax deduction against trading income**

The general principle is that where interest is incurred wholly and exclusively for the purpose of a trade carried on by the company in the period in which the interest is accrued, it is allowable as a trading expense.

**Tax deduction against rental income**

In general interest on money borrowed to purchase, improve or repair a rented property is allowed as a deduction against the related rental income in arriving at the taxable rental income under Case V of Schedule D of the Irish Taxes Consolidation Act.

The deduction is limited to 85% of the interest accruing on or after 1 January 2018 on loans for the purchase, improvement or repair of residential rental property, including foreign property loans. The deduction of interest on loans used to purchase, repair or improve rented commercial property is unrestricted.

**Interest as a charge on total income (for companies and individuals)**

Subject to certain conditions, interest relief may be available to a company or an individual on interest paid on monies borrowed to acquire shares in or loan money to a trading company or a company whose business consists wholly or mainly of holding stocks, shares or securities in such a company.

A company can also claim interest relief on loans applied in acquiring an interest in or loaning money to a company whose income arises wholly or mainly in the form of rents or other income from property. Relief is not available to an individual in such circumstances. Finance Act 2017 codified the long-standing Revenue practice of allowing the relief to apply in the case of interest paid in acquiring the shares in or lending to a company whose business consists wholly or mainly of the holding of stocks, shares or securities of a trading company indirectly through an intermediate holding company(s).

Subject to a number of conditions being met, interest relief is available and can be treated as a "charge". This means that it can be off-set against the company's total profits or, in the case of an individual, against the income for the year of assessment in which the interest is paid. The charge can also be used against profits in other group companies subject to certain conditions. It should be noted that this is a complex area which is subject to a number of detailed anti-avoidance provisions.

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

In the case of a share purchase, assuming that the conditions set out above in relation to interest as a charge are satisfied, interest relief may be available as a charge in respect of the interest paid on the funds borrowed to acquire the shares. Such interest is deductible against the total profits of the company. However, to the extent that there is excess interest, such current-year interest can be surrendered within a corporation tax group (i.e. a 75% group). The interest surrendered can be off-set against the other company's total profits, minimising its tax.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In general, there are no particular rules allowing a deemed interest deduction for equity contributions or a deduction for paid in capital.

Subject to certain restrictions, relief may be available to companies in respect of interest on monies borrowed to purchase, directly or indirectly, a trading company or a company whose income derives wholly or mainly from rents or other income from property.

Ireland does not have thin capitalisation rules.

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

**General rule for using trading losses forward**

Subject to anti-avoidance legislation, in general a trading loss in an accounting period may be carried forward indefinitely for off-set against the trading income from the same trade in succeeding accounting periods.

**Anti-avoidance legislation on sale of shares**

Where shares in a loss-making company are sold, specific rules apply to carrying losses forward. The legislation provides that relief for the losses forward is not available where:

- Within any period of three years there is both a change in the ownership of a company and (whether earlier or later in that period or at the same time) a major change in the nature or conduct of a trade carried on by the company, or

- At any time after the scale of the activities in a trade carried on by a company has become small or negligible and before any considerable revival of the trade, there is a change in the ownership of the company.

**The legislation defines "major change in the nature or conduct of a trade" as including:**

- A major change in the type of property dealt in, or services or facilities provided, in the trade, or
- A major change in customers, outlets or markets of the trade.

Following a spin-off (known as a "three-party-share-for undertaking swap") it should be possible for losses carried forward to be transferred where a trading company ceases to carry on a trade and thereafter another company carries it on, provided there is substantial identity in the ownership of the trade before and after the change. In order for losses to be available the following conditions must be met:

- there must be a transfer of and succession to a trade;
- an interest in the trade of at least 75% belongs to the same person at some time within one year before the change and at sometime within two years after the change; and
- between the times when the ownership test is satisfied, the trade is carried on only by a company within the charge to corporation tax.

There are no specific rules related to the transfer of losses on a domestic merger of private companies. The provisions which apply to spin-offs may be relevant for mergers depending on the circumstances. However, it is likely that Revenue confirmation would need to be sought on the point.

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

If the Irish target company has claimed any reliefs, allowances or credits any such claims should be reviewed to ensure such amounts were properly claimed. In particular where a target company has claimed research and development tax credits, it should be considered whether the activity would fall within the definition of "research and development" and whether the target has retained all necessary documentation. This is an area which Revenue scrutinise quite closely.

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

Stamp duty is generally payable on the transfer of shares in Ireland at a rate of 1% of the consideration paid for the shares or of the market value, whichever is the higher.

However, in certain circumstances stamp duty is payable at a higher rate of 6% for the transfer of shares which derive their value from Irish non-residential property. (See section 16 for further detail)

An exemption from Irish stamp duty is available for transfers which are part of a bona fide reconstruction or amalgamation and where certain conditions are met. An exemption from Irish stamp duty is also available for transfers between "associated companies". This exemption applies where both parties intend to, and in fact do, remain 90% "associated" for the two-year period following the transfer. In the case of a merger by absorption, as a result of which the transferor is dissolved, this test can be satisfied where the recipient retains the assets for the two-year period following the transfer and the beneficial owner of the ordinary shares in the recipient remains unchanged for the two-year period following the transfer.

It is worth noting that there is no stamp duty on the issue (as opposed to the transfer) of new shares.

The transfer of shares or other securities in a company is exempt from VAT.

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

If acquisition costs are capitalised they will form part of the base cost of the asset for CGT purposes and as such will not be deductible as a trading expense. Such acquisition costs should be deductible on a future sale of the property.

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

The purchase of shares is a VAT-exempt activity. Therefore, a company which incurs costs in relation to the acquisition of shares in a newly acquired entity is generally not entitled to recover the VAT on such costs.

However, there are specific circumstances where Revenue accepts that a company which has acquired shares in a new entity can recover a portion of the VAT incurred on such costs. Where the purchaser plays an active part in the management of the newly acquired entity and provides services such as accounting, administration or marketing services, then a portion of the VAT incurred on the costs can be recovered by the purchaser. Revenue reviews each transaction on a case-by-case basis. Therefore, each transaction should be reviewed individually to determine whether the purchaser of the shares is entitled to an element of VAT recovery on the costs incurred.

Generally, the transfer of assets is subject to VAT. However, depending on the VAT status of the seller and purchaser, where the assets transferred constitute a business or part of a business capable of being operated on an independent basis, the transfer is deemed not to be a supply for VAT purposes. This exemption applies to the transfer of tangible and intangible assets. It also applies even if the business has ceased trading. Certain conditions need to be met in order for the exemption to apply. There are provisions under Irish VAT legislation which may allow a company to recover VAT incurred on costs associated with the transfer of a business or part of a business.

Particular care should be taken to analyse the detailed rules which apply to immovable property.

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

A company that is non-resident in Ireland is generally only liable to Irish CGT on the disposal of ''specified assets,'' including land and buildings in Ireland and the shares of an Irish company which derives its value, or the greater part of its value, from Irish land or buildings.

A foreign company should be aware that when acquiring shares in an Irish company which derives its value, or the greater part of its value, from Irish land or buildings, the purchaser is obliged to withhold 15% of the consideration and remit same to Revenue unless the vendor provides a Form CG50 (CGT Clearance Certificate) (see point 16 below for further detail). This will be relevant on a future sale of the shares in any such Irish company as Revenue will only issue a Form CG50 to a non-resident where the non-resident has:

- satisfied Revenue that they have no CGT liability; or
- satisfied Revenue as to the amount of the CGT liability and that the tax will be paid by the non-resident.

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

The Companies Act 2014, which commenced on 1 June 2015, introduces a statutory framework for mergers and divisions between private companies in a purely national context for the first time under Irish law. Previously, mergers between private companies could generally only be implemented if there was a cross-border element to the transaction and by obtaining court approval. The Act allows for a merger of private domestic companies,

without the need for court approval. Finance Act 2017 introduced new measures designed to ensure that domestic mergers and divisions may be carried out in a tax neutral basis.

It should also be possible for a group to carry out a reorganisation in a tax neutral manner. Relief is available from corporation tax, CGT and stamp duty on intra-group transfers. It should be noted that the definition of a "group company" or "associated company" differs for CGT, corporation tax and stamp duty.

It should be noted that there are certain conditions which will need to be satisfied in order for the relevant tax reliefs to apply to mergers, divisions and reorganisations. In certain circumstances the reliefs may be clawed back.

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

A withholding tax applies where, on a purchase of shares in a company, the consideration exceeds €500,000 and the shares (other than shares quoted on a stock exchange) also derive their value or greater part of their value directly or indirectly from land and buildings in Ireland, minerals in Ireland or any minerals or mining rights, exploration, exploitation right in a designated area.

In these cases, under Section 980 of the Taxes Consolidation Act 1997, the purchaser must withhold from the consideration and remit to Revenue tax amounting to 15% of the consideration unless the vendor provides a Form CG50 (CGT Clearance Certificate). A CG50 is also required when the consideration for the shares exceeds €500,000, the shares were acquired following a reorganisation and the "old shares" fell within the category of shares outlined above.

The 15% withholding tax obligation does not apply if the seller obtains a CG50 from Revenue and delivers it to the purchaser prior to the consideration being paid.

**VAT**

Ireland has complex rules for VAT on property which should also be closely examined. A capital goods scheme tracks the use of a property over a 20-year period to ensure the VAT recovered reflects the use of the property over the period. An annual review will establish if there are any adjustments to be made. There are also record-keeping requirements over the life of the capital good.

**Close company**

A close company is a company which is controlled by five or fewer "participators". When there is surplus rental and investment income, a close company surcharge applies (at a current rate of 20%) if such income has not been distributed by the close company within 18 months of the end of the accounting period.

**Stamp Duty**

For transfers on or after 6 December 2017 of certain shares and interests in companies and funds which derive their value, or the greater part of their value, directly or indirectly from non-residential land and buildings in the State, the rate of stamp duty is 6%. This increased rate of stamp duty will apply where the transfer leads to a change in the control of the land or buildings and where the land or buildings were acquired or were developed for the sole or main object of realising a gain on its disposal.

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

There is no fiscal unity or consolidated tax grouping in Ireland. However, group relief may be claimed where one member of a group is entitled to surrender its trading loss to another member of the same group. In order to be deemed a member of a group, the following conditions must be satisfied:

- **(a)** one company must be a 75% subsidiary of the other company or both companies must be a 75% subsidiary of a third company;
- **(b)** the parent must hold 75% of the ordinary share capital of the subsidiary;
- **(c)** the parent must be beneficially entitled to not less than 75% of the profits available to equity holders; and
- **(d)** the parent must be beneficially entitled to not less than 75% of the assets available for distribution on a winding-up.

The 75% group relationship may be traced through companies resident in the EU, an 'EEA treaty country' or another country with which Ireland has a double taxation agreement (a "relevant territory"). In addition, in determining whether one company is a 75% subsidiary of another company for the purpose of the group relief provisions, the other company must either be resident in a 'relevant territory' or quoted on a recognised stock exchange in a 'relevant territory' or on another stock exchange approved by the Minister for Finance.

In general, the surrender of losses is only allowed by Irish resident companies, or, in certain cases, branches of companies which are resident in the EU or an 'EEA treaty country' that are within the charge to corporation tax in Ireland and such losses may only be surrendered to an Irish resident company. However, in certain circumstances losses that are incurred by a subsidiary company which is resident in an EU Member State or an EEA state with which Ireland has a double tax treaty may be surrendered to an Irish parent company. It must be shown that the loss being surrendered to the Irish parent company cannot be utilised in any other way by the foreign subsidiary.

In addition, group relief may be claimed from capital gains tax where there is a 75% direct or indirect group. Since Finance Act 2017 it is now possible to trace the group relationship through any country with which Ireland had a double tax treaty. Previously the group relationship could only be traced through companies resident in the EU or an EEA state which Ireland has a treaty with.

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

Finance Act 2015 introduced a new corporation tax regime for income arising from certain intellectual property. The regime is known as the Knowledge Development Box (KDB).

In brief, where a company qualifies for the KDB relief, it is entitled to a 50% allowance on its qualifying profits (as defined) which in effect, results in a 6.25% corporate tax rate on those qualifying profits. There are a number of conditions which must be satisfied to avail of the KDB.

The KDB provisions apply to accounting periods which begin on or after 1 January 2016 and before 31 December 2020. The KDB applies to "qualifying assets", being intellectual property, other than marketing related intellectual property, which has resulted from research and development activities.

Intellectual property is defined as:

- a computer program, within the meaning of the Copyright and Related Rights Act 2000 (this includes computer programs which represent a derivative work or an adaption of an original work);
- an invention protected by a qualifying patent or certain supplementary protection certificates;
- plant breeders' rights within the meaning of section 4 of the Plant Varieties (Proprietary Rights) Act 1980.

A "qualifying patent" includes a patent which was granted following a substantive examination for novelty and inventive steps. Accordingly, not all patent systems may fall within this scope. A short-term patent is not regarded as a "qualifying patent".

The KDB relief will apply to qualifying profits made in the course of a specified trade (as defined) which consists of one or more of the following –

1. the managing, developing, maintaining, protecting, enhancing or exploiting of intellectual property;
2. the researching, planning, processing, experimenting, testing, devising, developing or other similar activity leading to an invention or creation of intellectual property; or
3. the sale of goods or the supply of services that derive part of their value from activities described in (i) and (ii), where those activities were carried on by the relevant company.

In order to ascertain the amount of profits arising from qualifying assets which can avail of the KDB relief, the below formula is used:

$$\frac{QE + UE}{OE} \times QA$$

where –

- QE is the qualifying expenditure on the qualifying assets. This is the expenditure incurred wholly and exclusively by a company in the research and development activities of the qualifying asset, such activities having taken place in the EEA. Companies should note that outsourcing to unrelated parties in any jurisdiction can be included and this differs from the treatment for the purposes of research and development credits. Certain items are excluded from the definition of qualifying expenditure including acquisition costs, interest and intra group expenditure. However, some excluded expenses can be "saved" to some degree by means of the
uplift expenditure.
- UE is the uplift expenditure. This is the lower of 30% of the qualifying expenditure or the aggregate of acquisition costs and group outsourcing costs (as defined).
- OE is the overall expenditure on the qualifying asset being the total of qualifying expenditure, acquisition costs and group outsourcing costs.
- QA is the profit of the specified trade relevant to the qualifying asset (before taking account of any KDB allowance)

The KDB was the first patent box to be recognised as being fully compliant with the OECD "modified nexus" as set out in the final reports of the OECD's Base Erosion and Profit Shifting ("BEPS") Project.

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

There are no particular adverse tax consequences associated with a transfer of intangibles out of Ireland. Any gain arising on the disposal of intangible assets may be subject to CGT (currently at a rate of 33%) (see section 20 for further detail).

# 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?

**CGT for residents**

The current rate of Irish CGT is 33%. Individuals who are resident or ordinarily resident and domiciled in Ireland are liable to Irish CGT on their worldwide gains. The charge to CGT applies to individuals, trusts, unincorporated bodies and companies in the case of development land gains.

Companies resident in Ireland are taxed on chargeable gains, other than for development land, at the same rate as CGT, but the tax falls under corporation tax liability. As a general rule, companies incorporated in Ireland are resident in Ireland. However, an Irish incorporated company regarded as not resident in Ireland by virtue of a tax treaty is treated as not being tax resident in Ireland. A company can also be tax resident in Ireland (whether it is incorporated here or not) if its central management and control is exercised in Ireland.

**CGT for non-residents**

A company that is non-resident or an individual who is neither resident nor ordinarily resident is liable to Irish CGT on the disposal of "specified assets," including land and buildings in Ireland and the shares of an Irish company which derives its value, or the greater part of its value, from Irish land or buildings.

An individual who is resident or ordinarily resident in Ireland but not domiciled is liable on gains from the disposal of Irish situate assets in full and on gains from the disposal of foreign assets to the extent that the gains are remitted into Ireland.

An individual who is temporarily non-resident in Ireland may, under Irish anti-avoidance legislation, be liable to Irish tax on any chargeable gain realised on a disposal during the period in which such individual is non-resident.

**Participation exemption regime (applies only to companies)**

Subject to certain conditions, capital gains realised on the disposal by an Irish resident company of shares in another Irish company or in companies resident in another EU country or a country with which Ireland has a double taxation treaty will generally be exempt from Irish CGT provided the following criteria are met:

- The shares disposed of must be held in a company that is, at the time of the disposal, resident for tax purposes in either an EU member state (including Ireland) or a country with which Ireland has a double taxation treaty
- The company that disposes of the shares must, either directly or indirectly:
    - hold least 5% of the company's ordinary share capital
    - be beneficially entitled to at least 5% of the profits available for distribution to equity holders of the company, and
    - be beneficially entitled in the case of a winding up at least 5% of the assets available for distribution to equity holders for a consecutive period of 12 months ending not more than two years before the date of disposal
- Either the subject company alone or, alternatively, the combination of the subject company, the disposing company and every other company in which the disposing company holds a 5% or more equity interest, considered as a whole, must exist wholly or mainly for the purposes of carrying on a trade or trades
- The shares disposed of must not derive their value or the greater part of their value from land or mineral rights in Ireland, or be held as part of a foreign business fund

The exemption extends to disposals of certain assets related to shares, including options over shares, securities convertible into shares or options to acquire securities convertible into shares.

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

Generally, there is no rollover relief available in Ireland.

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

There are no requirements for holding or finance companies to have a certain level of substance. However, where a company has no substance in Ireland this will impact on the company's VAT recoverability and the corporate tax rate which will apply. It would be necessary to consider whether any foreign tax implications would arise in such circumstances and whether benefits under the relevant tax treaty would be available.

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

As indicated above at section 15, Finance Act 2017 introduced new measures designed to ensure that domestic mergers may be carried out in a tax neutral basis.

**Stamp Duty**

Cross border mergers effected under the EU Regulations should not be subject to stamp duty. Relief from stamp duty should be available on domestic mergers and spin offs provided certain conditions are met.

**Capital Gains Tax**

Relief from CGT should be available in respect of a pre-sale spin-out known as a "share-for-undertaking three party swap". This involves the Target's business being transferred to new company set up outside the group in consideration of the issue of shares to the shareholder of the Target. A specific indemnity is usually sought for any liabilities (including tax liabilities) related to the reorganisation.

CGT relief should be available in respect of cross-border mergers effected under the EU Regulations. In respect of domestic mergers, CGT relief should be available subject to certain conditions.

**VAT**

No VAT should arise on a transfer of shares as part of a spin-out/merger. Transfer of business relief may apply to any transfer of assets such that any such transfer taking place pursuant to a merger/hive-out should not be deemed to be a supply for VAT purposes.

# MANAGEMENT INCENTIVES

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

**Approved Share Option Scheme**

Income tax relief will be available where a right to acquire shares in the company is granted by the company to its employees or directors and exercised in accordance with a share option scheme that has been approved by the Revenue Commissioners. A three-year claw back provision applies. In order to qualify for an approved share option scheme, the scheme must be made available to all employees and directors at the same time subject to a maximum service requirement of three years. There is scope to include a "key employee" element to an approved share option scheme but the scheme cannot be limited to key employees only. The total number of shares granted to key employees or key directors cannot exceed 30% of the total number of shares in respect of which rights have been granted to all employees and directors under the scheme. Where a share option scheme has not been approved by Revenue, income tax and CGT at the normal rate will apply. Entrepreneurial relief will apply to the liability to CGT where the individual disposing of the shares holds at least 5% of the company's ordinary share capital. In such circumstances, CGT will be chargeable at 10% rather than the standard rate of 33%.

**Key Employee Engagement Programme**

Finance Act 2017 introduces a new initiative which provides for advantageous tax treatment of gains arising on the exercise of qualifying share options acquired in SME companies. An SME is a company which employs fewer than 250 people and has an annual turnover not exceeding €50 million and/or an annual balance sheet total not exceeding €43 million.

Specifically, the regime exempts any gains realised on the exercise of qualifying share options granted between 1 January 2018 and 31 December 2023 from income tax, social security and the Universal Social Charge. However, the gain remains chargeable to CGT on future disposals on the shares. To qualify for the regime, the share option must be held for at least 12 months, but must be exercised within 10 years.

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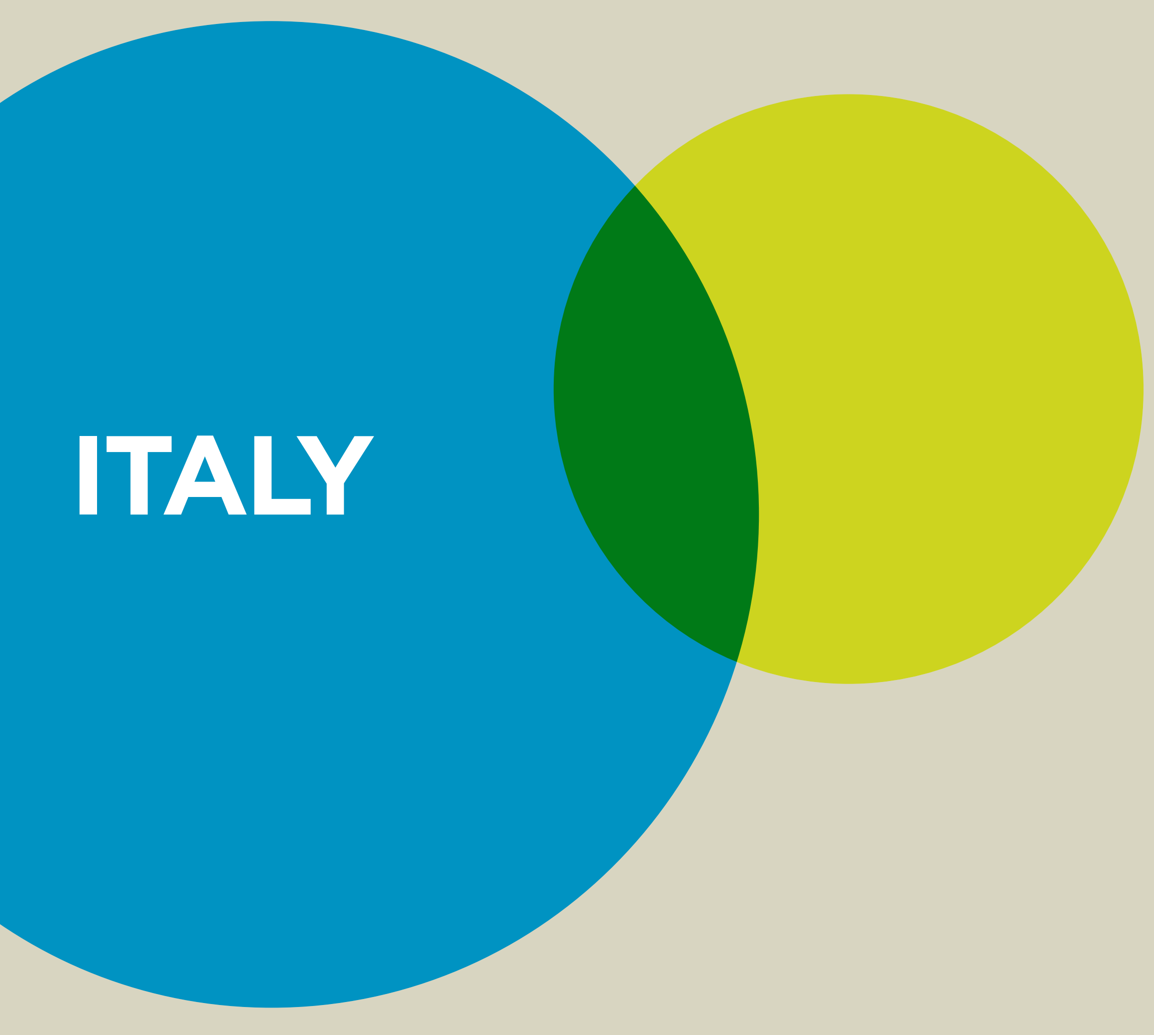

# ITALY

# ITALY

## INTERNATIONAL DEVELOPMENTS

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

Recent tax law amendments include, among others:

- corporate income tax rate (IRES) has been set at 24% starting from 1 January 2017 onwards (with a 3.5% surcharge for banks and financial institutions)
- a patent box regime in line with the OECD approach
- new types of rulings, including (i) special rulings for companies with large investments to be realised in Italy (over Euro 30 million) or (ii) rulings in order to have certainty upon the existence of an Italian PE, the profits attributable to such PE and the correctness of the transfer pricing policy of multinational groups
- a revision of the CFC legislation and the abolition of rules on non-deductible costs charged by companies resident in black-listed countries
- a tax exemption regime for income deriving from qualified long-term (5 years) investments made by pension funds into (i) Italian companies or EU/EEA entities with a permanent establishment in Italy or (ii) Italian/EU/EEA investment funds which mainly invest in companies under (i)

In addition, the Italian Budget Law for 2018 (Law. No. 205 of 27 December 2017) provided for some material changes that may have an impact on multinational enterprises. In particular:

- Web tax
- definition of permanent establishment
- interest limitation rule
- VAT group regime
- recharacterization rule for registration tax purposes
- taxation of dividends and capital gains from substantial participations

**Web tax** – Starting from 2019 a new tax on digital services provided to Italian enterprises and Italian permanent establishments of foreign entities is introduced. Web tax will be levied at a 3% rate on the value of each transaction. It will apply to resident and non-resident digital service providers which in a calendar year carry on more than 3,000 transactions.

**Definition of permanent establishment** – The domestic definition of permanent establishment (PE) has been amended in line with the OECD's recommendations included in the 2015 Final Report on BEPS Action 7. In particular, the Budget Law: (1) qualifies as PE a significant and continuous economic presence in Italy which does not result in a physical presence; (2) introduces an anti-fragmentation rule; (3) in relation to the list of excluded activities, introduces the condition under which such activities must be of a preparatory or auxiliary nature; (4) extends the definition of agency PE.

**Interest limitation rule** – The interest limitation rule has been amended in line with Article 4 of the EU Anti-Tax Avoidance Directive (2016/1164). From FY 2017, dividends received from controlled foreign companies are no longer included in the calculation of the EBITDA for interest limitation purposes.

**VAT group regime** – Italian VAT group regime has been amended to implement the principles of the ECJ Case Skandia (C-7/13). As a consequence, supplies of goods and services carried on between a head office and its branch are relevant for VAT purposes if the head office or the branch are part of an Italian VAT group.

**Recharacterization rule for registration tax purposes** – According to the new rule, registration tax applies on the intrinsic nature and legal effects of each single deed subject to registration. In this respect, for example, tax authorities may no longer recharacterize a sale of shares (subject to EUR 200 registration tax) as a sale of a business going concern (subject to registration tax at proportional rates).

**Taxation of dividends and capital gains from substantial participations** – The new rules concerning the taxation of dividends and capital gains from substantial participations provide the following:

- Dividends and capital gains arising from substantial shareholdings (i.e. more than 20% of voting rights or 25% of the paid-in share capital in the company if the company is not listed, and respectively 2% and 5% if the company is listed) held by resident individuals and not connected to a business activity are now subject to a 26% final withholding or substitute tax (previously included in the general taxable base for the 58.14% of their amount and taxed at the ordinary progressive tax rate)
- Capital gains realized on substantial shareholdings held in Italian resident companies by non-resident persons (that do not hold the shares through an Italian PE) are now subject to a final 26% substitute tax (previously 58,14% of the capital gain was subject to the ordinary IRES rate of 24%) - unless a DTT prevents Italy from taxing the gain. As a general rule - unless a more favourable domestic or conventional regime applies - also before these changes non-resident persons were subject to a 26% withholding tax on dividends deriving from substantial shareholdings held in Italian resident companies

This new tax regime applies to dividends paid as of 1 January 2018 and to capital gains realized from January 1st, 2019.

## 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?

Italy signed the MLI during the formal signing ceremony on 7 June 2017 but has not ratified the MLI yet. It is worth mentioning that Italy made the reservation provided in Article 35(7)(a) of the MLI according to which the entry into effect of the MLI occurs 30 days after the notification that Italy has completed “its internal procedures for the entry into effect of the provisions of this Convention with respect to that specific Covered Tax Agreement”.

As far as Action Plans 6 is concerned, in the MLI Italy expresses its preference to apply PPT only.

In addition, some recommendations provided by the other BEPS Action Plans have already been introduced into Italian laws, e.g.:

- obligation of the country-by-country reporting for Italian multinationals (over Euro 750 million turnover), and Italian subsidiaries if the controlling company is not subject to the same rule in its country or there is not a treaty allowing exchange of information
- income paid by foreign companies may be taxable as a “dividend” (i.e. substantially exempt) only if it can be demonstrated that the same payment has not been deducted from the taxable income of the foreign company (rule against hybrid mismatches)
- a new anti-abuse rule (GAAR), which unifies the previous anti-avoidance tax law and the jurisprudential concept of the abuse of law, was introduced in August 2015 and is applicable to transactions after 1 October 2015 (and also prior to that date if the assessment is notified after that date). The new rule technically defines the concept of “abuse of law” according to the rules on aggressive planning and is in line also with the concepts described in the EU Parent –Subsidiary Directive. Transactions are deemed to lack economic substance when they involve facts, actions and agreements that cannot generate significant business consequences other than tax advantages. As indicators of lack of economic substance, the GAAR makes

reference to cases where there is an inconsistency between the qualification of the transactions and their legal basis as a whole and where the choice to use certain legal instruments is not consistent with the ordinary market practice. In the presence of proper business purposes (other than of a tax nature), including improving the organisational and managerial structure of the business, taxpayers should be free to pick and choose the transaction which triggers the lowest tax burden possible.

- on 21 February 2018, the Italian Ministry of Finance invited interested parties to provide comments on the discussion drafts related to the implementation of the Italian Transfer Pricing rules. In particular, three documents were released:

  **a)** a Draft Ministerial Decree providing guidelines for the application of the arm's length principle. It is worth mentioning that the Italian Transfer Pricing rule provided by Article 110(7) of the Italian Tax Code was recently amended by article 59 of the Law Decree n. 50/2017. The new provision basically rephrases the arm's length principle as is contained in article 9 of the OECD Model Tax Convention

  **b)** a Draft Revenue Agency Regulation implementing the request for unilateral downward Transfer Pricing adjustment (so-called corresponding adjustment). Indeed, according to the recently introduced article 31-quater of Presidential Decree 600/1973, in case of a foreign primary Transfer Pricing adjustment, the Italian Revenue Agency can recognize a downward adjustment not only in execution of a Mutual Agreement Procedure but also upon formal request by the taxpayer

  **c)** a Draft translation into Italian of the 2017 OECD Transfer Pricing Guidelines

## GENERAL

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

**A) Share deal**

Such transactions concern the transfer of shares or quotas of a company which owns the business the purchaser is interested in. The transaction may concern an existing company or a new company in which the relevant business is first included through an extraordinary transaction (like a spin off or a demerger).

**Tax advantages:**

- The capital gain realised by the seller can be subject to a reduced income tax burden depending upon the type of seller; in particular it could be beneficial for domestic companies (when the conditions for the participation exemption regime are applicable) and for foreign companies (if a double tax treaty relief for capital gains is applicable)
- In a share deal the tax attributes carried forward (losses, interests paid exceeding limits, tax credits, etc.) stay with the company acquired and can be part of the deal, even if they are subject to certain limitation rules aimed to avoid the "trade" of attributes; please note that if the majority of the shares of a company are transferred and there is a change in the company's activity prior or after such transfer, the prior years' tax losses expire unless certain requisites are met
- A share deal is not subject to indirect taxes, unless the shares of an Italian joint stock company ("società per azioni") are sold, in which case a 0.2% tax (Tobin tax) has to be applied

**Tax disadvantages:**

- In a share deal all the contingent tax liabilities remain in the company whose shares are sold for the statute of limitations period, i.e. until 31 December of the fifth year following the filing of the tax return for 2016 onwards (for fiscal years until 2015 the reference is to the fourth year subject to a potential extension to eighth year in case of criminal proceedings) and therefore the buyer should in principle seek guaranties of the tax risks

- In a share deal, in principle there is no step up of the value of assets unless certain extraordinary transactions are carried out and/or a specific option is exercised which implies the payment of a substitute tax
- The deal may not include all the assets/liabilities of a company and therefore a preliminary carve out into a specific company may be needed which might have some tax costs. However, the contribution of a going business into a company in exchange for shares is a tax neutral transaction that does not change the tax values of the companies involved, and allows the seller in principle the possibility to apply the participation exemption regime on the subsequent sale of the new shares

**B) Asset deal**

Such transaction concerns the acquisition of assets or more frequently of a going business previously identified between the parties.

**Tax advantages:**

- In an asset deal the buyer acquires tax benefits, i.e. it implies a step-up for tax purposes in the depreciable basis of assets transferred corresponding to the purchase price paid allocated to each asset
- In an asset deal the tax attributes (tax losses or unused interest) remain with the selling company and are not transferred to the buyer, and this may represent an advantage for the seller in particular if the conservation of such tax attributes in a share deal is not possible due to the rules on "trade" in tax attributes
- In an asset deal the contingent tax liabilities relating to the assets or the going concern transferred remain as a general rule with the selling company. However, pursuant to Article 14 of Decree no. 472/1997, the buyer of a going concern is jointly and severally liable with the seller for the most recent tax liabilities in an amount not exceeding the value of the assets. A tax certificate stating the amount of tax liabilities attached to the going concern can be requested from the tax authorities and the buyer's liabilities are limited to the amount stated in the certificate. These liability rules do not apply if the asset deal occurs in a pre-bankruptcy regulated procedure

**Tax disadvantages:**

- In an asset deal the capital gain (loss) realised by the selling company is taxable (deductible) for corporate tax purposes at IRES ordinary rates (in the case of assets owned for more than three years, the gain may be deferred over at most five fiscal years) and is not subject to IRAP if the asset deal consists of a going concern
- When the asset deal is realised through the transfer of a going concern, no VAT is applied and the value of the going concern, net of liabilities, is subject to a registration tax and other ancillary taxes when real estate is present; the transfer taxes are paid usually by the buyer, but both parties are jointly and severally liable for the payment of registration tax (which is generally applied at a 3% rate, except for real estate assets which are mainly subject to 9%)

## 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?

If the target company is subsequently merged with the acquiring company, the possible merger deficit (disavanso di fusione – i.e. the difference between the cost of cancelled shares and the book value of the net assets of the absorbed company) can be used to step up the value of the assets from an accounting point of view. Such step up is not relevant for tax purposes unless the company exercises one of the following options regarding, in full or in part, one or more assets:

- **a)** the absorbing company is entitled to step up the tax value of the tangible and intangible assets received by paying a substitute tax at the rate of 12% on the portion of the step-up in value up to Euro 5 million, 14% on the portion of the step-up from Euro 5 million to Euro 10 million, and 16% on the portion of the step-up in value exceeding Euro 10 million. The option for the step-up can be elected in the tax return of the year in which the merger occurs or in that of the following tax year. The stepped-up tax values are effective starting from the fiscal year in which the option is exercised, subject to a recapture rule if the assets are disposed within the four fiscal years following the one in which the option is exercised
- **b)** according to another specific provision, the step up may affect the tax value of intangible assets (goodwill, trademarks and other intangible assets) and is granted by paying a substitute tax of 16%. This specific regime allows the taxpayer to apply a depreciation period of 5 years for deducting goodwill and trademarks instead of the ordinary 18 years period. The substitute tax must be paid within the deadline for the payment of the IRES due for the fiscal year in which the merger occurs (i.e. the last day of the 6th month of the following fiscal year). The stepped-up tax values are effective starting from the fiscal year in which the substitute tax is paid, subject to a recapture rule if the assets are transferred within the fourth fiscal year following the one in which the option is exercised. The higher depreciation/amortization can be deducted starting from the fiscal year following the one in which the substitute tax is paid
- **c)** in addition, if the absorbing company inherits a participation from the absorbed company and includes it in its consolidated financial statement (CFS), the step up may affect the values of goodwill, trademarks and other intangibles recognized in such CFS and implicitly embedded in the value of that participation. The step up at stake is notional and can be deducted by the absorbing company. This regime can be applied in the same periods and is subject to the same recapture rules already mentioned under (b) but the depreciation/amortization can be deducted starting from the second fiscal year following the one in which the substitute tax is paid

Moreover, given that the same step up regime, as described above under (c), is generally allowed where the qualified participation is acquired for consideration in a share deal, if the Italian acquiring company does not merge the target, but includes it in its consolidated financial statement, the step-up regime can be applied.

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

From an accounting viewpoint the goodwill acquired in a transfer of a going concern (asset deal) can be amortized over its useful life, or, if such life cannot be reliably estimated, over at most 10 years. For tax purposes, the goodwill must be amortized over no less than 18 financial years.

In cases where the goodwill has been subject to the optional regimes described in Section 4 and the taxpayer voluntarily pays the 16% substitute tax, the tax depreciation period of the goodwill can be reduced to no less than 5 fiscal years, irrespective of its accounting depreciation.

Please note also that trademarks are treated for tax purposes exactly like goodwill (both in ordinary and special regimes).

## 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 Article 96 of the Italian tax code, net interest expense (i.e. interest expense less interest income) is deductible up to an amount equal to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) as shown in the profit and loss statement.

Interest expense exceeding the 30% EBITDA threshold is not deductible in the relevant fiscal year, but is carried forward to the following fiscal years (without any time limit) and may be deducted in a subsequent fiscal year if

and to the extent 30% of EBITDA is higher than net interest expense in that fiscal year. If 30% of EBITDA exceeds net interest expense, such excess limitation can be carried forward to offset - in the future - excess interest.

In addition, excess interest expense generated by one company in a tax consolidation may be offset against the excess 30 percent of EBITDA of another company of the tax consolidation.

In a merger or a demerger, excess interest carried forward is subject to the same limitations as are imposed on the carrying-forward of tax losses (see Section 9.).

The above is applicable only for corporate income tax (IRES) while for regional income tax (IRAP) interest is fully nondeductible.

The described regime is not applicable to companies operating in the banking and finance industries, for which from 2017 interest is fully deductible for both income taxes (IRES and IRAP). For companies operating in the insurance industry, the Italian tax code allows a deduction of 96% of interest expense accrued both for IRES and IRAP.

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

Acquisitions of shares in an Italian target company are made through the merger of the acquiring new company (Newco) and the target (leveraged buyouts) so that the debt is pushed down into the surviving company and interest expense accrued on that debt is utilized to offset revenues generated by the target.

If, for whatever reason, a merger is not feasible, another option is to consolidate Newco and the target company in a domestic fiscal unity so that the target's tax position can be offset by Newco's tax position.

In the Circular Letter n. 6/E of 30 March 2016 the tax authorities have analyzed various tax issues regarding leverage buy-outs, confirming that:

- in principle such transactions (and the tax deduction for interest paid) cannot be challenged under the "abuse of law" doctrine, except in special cases of artificial structures, such as when the buyout structure is put in place by the same persons who were controlling the target company
- if the funds available for the acquisition of the target have been put at disposal of the Newco by the foreign entities of the group, this has to be considered as an intercompany service and subject to transfer pricing rules
- the tax authorities may recharacterize a shareholder loan as an equity injection according to OECD Guidelines if, on the basis of the specific facts and agreements, the economic substance of the transaction is such that it differs from a loan and is more/very similar to an equity contribution. As a consequence, interest paid on the recharacterized loan would not be deductible, but the loan would be relevant to the calculation of the deemed deduction provided by the ACE tax benefit as described in Section 8

The upstreaming of dividends may be another available strategy for pushing down debts, taking into account that only 5% of a dividend is taxable.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Italy's tax system provides a deduction (so called "ACE") from corporate income tax (IRES) of a deemed interest computed by applying a certain rate to the net equity increases arising after 2010 (equity contributions and undistributed profits less reductions of equity with respect to shareholders).

It is worth mentioning that, under a specific set of anti-abuse rules, the ACE base may be reduced in certain situations that entail the risk of "undue duplication" of the ACE benefits. Such situations are the following:

1. cash contributions between two members of the same group. The ACE base must be reduced at the level of the contributing company for an amount equal to the contribution made

2. acquisition of participations in controlled companies. The ACE base must be reduced at the level of the acquiring company for an amount equal to the price paid
3. acquisition of going concerns from group companies. The ACE base must be reduced at the level of the acquiring company for an amount equal to the price paid
4. increase of intercompany loans to group companies as compared to 2010. The ACE base must be reduced at the level of the lender for an amount equal to the loan granted. In this case, at the time of the loan repayment, the anti-abuse rule is neutralized

However, should such transaction not trigger an "undue duplication" of the ACE benefits, the anti-abuse rule may be made inapplicable by filing a specific request with the Italian tax authorities or flagging a specific box in the tax return.

The rate applied in computing ACE benefit was 1.6% for fiscal year 2017 and 1.5% from 2018 onwards.

Please note that an unused ACE deduction can be carried forward indefinitely or used to offset IRAP tax; unused ACE deduction can be also surrendered to the domestic fiscal unity.

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

In principle tax losses can be carried forward without any time limit but can be used to offset only 80% of taxable income in any year.

Limitations on the carryforward of tax losses apply when the following conditions are both met:

- a majority of the voting shares in the loss company is transferred, and
- the main activity carried out by the company is changed from the one carried out in the fiscal years when losses were suffered. The change in the activity has to occur in the fiscal year in which the shares are transferred, during the previous two years, or the following two years

Nevertheless, even if the above conditions are met, a company can still carry forward losses if, during the two years before the transfer of shares, it did not reduce employees below 10 units, and it satisfies the "vitality test." "Vitality" is deemed to exist if the company's P&L for the fiscal year preceding the one during which the change of control occurs shows gross receipts (and other proceeds deriving from the main activity) and labour costs (and related social security contributions) in excess of the 40% of the average (same) receipts and costs of the two previous financial years.

In a merger (or demerger), tax losses carried forward by companies involved are available for the absorbing company (i.e., the surviving entity), on the condition that the "vitality test" (see above) is satisfied, and in an amount not exceeding the net equity computed without taking into account any contributions and payments to equity made during the prior 24 months.

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

It should be carefully determined which is the applicable statute of limitations since for years through 2015 the period can be doubled if there has been any referral to a public prosecutor (irrespective of the outcome of the criminal proceeding).

If there are tax losses or excess interest to be carried forward, the impact of the rules which may limit the subsequent use of such tax attributes must be evaluated.

Transfer pricing issues must also be considered, since tax audits frequently raise such issues. It should be determined whether the company has proper TP documentation according to Italian TP rules in order to avoid the imposition of penalties in the event of tax assessments.

Finally, the situation of foreign subsidiaries must be monitored since tax authorities may deem in certain situations that such companies are tax resident in Italy and therefore subject to taxation.

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

In a share deal, a financial transaction tax at a 0.20% rate applies to transfers of shares of joint stock companies ("società per azioni") having their legal seat in Italy, even if not carried out on financial markets. In addition, the transfer of shares is exempt from VAT and a fixed registration tax of Euro 200 is levied.

In an asset deal, indirect taxes depend upon the type of transaction:

- If a going concern is transferred, no VAT is applicable and a registration tax is applied on the market value of the assets transferred, including goodwill, net of liabilities transferred, as reported in the accounting books of the company. The applicable tax rate depends on the nature of assets transferred. Movable property, goodwill, patents and trademarks, inventory, etc., are taxed at the rate of 3%, while real estate assets are taxed mainly at the rate of 9%
- The transfer of an isolated asset (i.e., not a business as a going concern), by a VAT-taxable person will likely be subject to VAT

For financing acquisitions, any bank loan for a term of more than 18 months that is concluded in Italy is optionally subject to a 0.25% substitute tax (imposta sostitutiva) applied on the amount of the loan. This tax replaces other indirect taxes due on guaranties like mortgages, pledges, etc., related to the bank loan.

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

In a share deal, the costs directly related to the participation acquired must be capitalized as an ancillary cost of the participation (and therefore are not tax deductible). If, instead, all or part of the costs are related to the financing received for the acquisition, it is possible to treat such costs as ancillary costs of the financing and deduct them over the term of the financing (subject to the same limitations as the interest paid).

In a leveraged buyout, the costs related to the acquisition (i.e. the management fees and the other fees charged by the Private Equity Fund to the target company) are deductible provided that they comply with the arm's length principle and reflect services actually performed for the benefit of the Italian target company. Therefore, in general the deduction is disallowed when such costs are, de facto, a portion of the costs that the manager should charge to the investors or the other members of the Private Equity Firm as related to services carried out for their benefit.

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

In case of a share deal, the treatment of the VAT paid on acquisition costs depends upon the general principles of VAT, i.e. the VAT paid on such service costs must have a direct and immediate link with the output transactions.

According to Article 4 of Italian VAT Law, no VAT can be deducted if the acquiring company is a holding company operating without any direct structure  designed to exercise financial activities or other activities of direction, coordination or management of the portfolio companies. If instead the holding company actively participates in the management of its portfolio companies, the link with the VAT output transaction may be found to exist, so that VAT paid may in principle be recovered.

According to the Circular Letter n. 6/2016 the same principles apply in a merger leveraged buy-out, where the VAT recovery is not allowed if the acquisition company is not involved in the management of the target.

In an asset deal, VAT paid on acquisition costs is in principle deductible from VAT due, unless the going concern carries on a VAT exempt activity.

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

For foreign shareholders the taxation of profit repatriation and of capital gains on exit are relevant.

Outbound dividends are subject to a final WHT of 26%, except in the following cases:

- zero WHT where the EU Parent-Subsidiary Directive 435/90/CE is applicable
- a 1.375% (reduced to 1.20% for distribution of profits earned from 2017 onwards) WHT on dividends paid to EU companies or to companies of the European Economic Area providing exchange of information, if they are subject to ordinary income tax in their country
- a reduced rate (generally 5% or 10%) may be provided by the applicable tax treaty

Capital gains realized on the sale of substantial participations through 31 December 2018 are subject to IRES at a rate of 24% levied on 58.14% of the capital gain. Starting from 1 January 2019 a final substitute tax of 26% will apply on the whole amount of the capital gain.

On the other hand, capital gains realized on the sale of non-substantial participations are in principle subject to a final substitute tax of 26% on the whole amount of the capital gain. However, capital gains on the disposal of a non-substantial participation is not subject to tax in Italy if one of the following conditions is met:

- the sale concerns "non-qualified" participations held in an Italian listed company; or
- the sale concerns "non-qualified" participations held in an Italian company and the seller is a resident of a whitelisted country

In any case, the capital gain realised by a foreign company upon disposal of a participation in an Italian company is not taxable in Italy if an applicable tax treaty grants the exclusive right to tax the gain to the State of residence of the holding company.

Circular Letter n. 6/2016 clarified that the application of the above rules on dividends and capital gains should be carefully monitored if the foreign company does not have sufficient substance or is a conduit (as better described in Section 20).

Moreover, reduced treaty rates apply to the payment of dividends/interests/royalties by Italian companies to a foreign holding/finance company only if the foreign company is the beneficial owner of the payments.

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

Italian law provides for a tax-neutral regime applicable to some qualifying corporate restructurings, such as mergers, de-mergers, contributions-in-kind and exchanges of shares. Under this tax-neutral regime, capital gains taxation is deferred and the acquiring entities receive a carryover basis in the assets acquired.

In transactions which allow the transfer of tax attributes (like mergers and de-mergers), particular attention has to be paid to the limitation rules (described in Section 9) which apply to tax losses and excess interest carried forward.

The main caveat in tax-neutral restructurings is the new rule regarding "abuse of law" (Article 10-bis of Law n. 212/2000) which is applicable to transactions lacking economic substance which realise undue tax benefits and consequently can be disallowed by the tax administration.

Taxpayers may request a ruling to determine whether a planned transaction may constitute abuse of law. No criminal charges would be imposed on the "abuse of law" behaviour.

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

In a share deal it must be taken into account that the favourable participation exemption regime for the selling company (see Section 20) does not apply to the transfer of shares in real estate companies (so these capital gains are subject to corporate income tax at the ordinary rate).

A real estate company is defined as a company whose assets have mainly consisted of real estate at any time during the last three fiscal years before the shares are sold. Properties used in a commercial activity are not deemed to be real estate assets for capital gain purposes.

In an asset deal, the sale of commercial real estate by a VAT taxpayer is VAT exempt or, at the option of the seller, is subject to ordinary VAT with the reverse charge system; in any event, a 3% cadastral tax and a 1% mortgage tax are due (reduced by half if a real estate fund is part of the transaction).

In case of a sale by a non-VAT taxpayer, the sale is subject to registration tax at a 9% rate in the case of a commercial building and 12% in the case of agricultural land (cadastral and mortgage tax are applied in a fixed amount of Euro 200 each).

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

The Italian tax consolidation regime provides for the determination of a single taxable basis, which is the sum of the taxable bases of the group entities, taken into consideration at their full amount, irrespective of the percentage of participation held by the consolidating company. As a consequence, taxable profits and losses realized by each company during the period of tax consolidation are offset. Conversely, tax losses suffered by each company before entering the domestic tax consolidation can be utilized only by the company that incurred them.

Other benefits of the regime are that (i) certain tax attributes (such as ACE and excess interest limitation) not used by the company creating them can be surrendered to the fiscal unity and (ii) the tax loss carryforward rules do not apply in mergers between consolidated entities.

If a company is owned by other companies with shareholdings ranging between 10% and 50%, a fiscal transparency regime can be elected so that the owned entity is not taxed for IRES purposes and its income /loss is transferred proportionally to the shareholders.

All the above regimes apply only for purposes of the corporate income tax (IRES), whereas local income tax (IRAP) remains applicable on a stand-alone basis.

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

The Italian Budget 2015 introduced an optional patent box regime, which grants a 50% exemption to income derived from the exploitation or the direct use of a qualifying IP both for corporate income tax (IRES) and local tax purposes (IRAP). In addition, the regime grants a 100% exemption on capital gains arising from the sale of qualifying IP under certain conditions.

The main aspects of the new patent box include the following.

- **Elective:** The Italian patent box regime is elective. The election is irrevocable and lasts for five years
- **Qualifying taxpayer:** Both resident entities and permanent establishments of non-resident entities may opt for the regime (in the case of a non-resident, only if it is are resident in a country that has a bilateral tax treaty with Italy and if the exchange of information between Italy and its country of residence is effective)

- **Qualifying IP:** The regime covers patents, know-how and other intellectual property subject to legal protection. The qualifying IP may be either self-developed or acquired. The regime applies if the taxpayer performs R&D activities to maintain/develop the qualifying IP. The taxpayer may perform R&D activities by itself or it may outsource them to third parties. Beginning in 2017, trademarks are excluded from the patent box regime
- **Income exemption:** The regime grants a 50% exemption of income derived from the exploitation or the direct use of qualifying IP, both for corporate income tax (IRES) and local tax purposes (IRAP). If the qualifying IP is directly used by the taxpayer, an advance ruling with the Italian tax authorities is required to determine the income allocable to the qualifying IP. "Directly used" means that the taxpayer uses the qualifying IP itself, without licensing it to other entities
- **Capital gain exemption:** Capital gains arising from the sale of qualifying IP will be totally exempted if at least 90% of the sale's consideration is reinvested, within the following two fiscal years, in the maintenance or development of other qualifying IP. The qualifying IP, as stated above, may be either self-developed or acquired
- **OECD "nexus approach":** The regime is in line with the OECD "nexus approach." The regime only applies to the amount of income derived from the qualifying IP, which is determined by applying the ratio of (1) R&D expenditures incurred by the taxpayer for maintaining/developing the IP, increased by part of the costs of the acquisition of the IP, if any, to (2) the total cost of producing that IP.

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

The transfer of the ownership of intangibles gives rise to a capital gain (loss) that is taxable (deductible) for income tax purposes. In addition, if the intangible is transferred to an affiliated company, the transfer should be at arm's length.

## 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?

Italian companies are entitled to a 95% participation exemption (i.e. only 5% of the capital gain on the disposal of shares in another company is subject to IRES at the rate of 24%) if the following requirements are met:

**a)** the shareholding has been held at least since the first day of the 12th month prior to the disposal

**b)** the shares were booked by the seller as a long-term investment (fixed financial asset) in the first balance sheet of its holding period (no minimum percentage is required)

**c)** the owned company is not resident in a tax haven

**d)** the owned company is carrying on a real business activity (e.g. other than real estate companies or intangible portfolio companies)

The requisites under c) and d) must be fulfilled throughout the three fiscal years prior to the sale.

If the requirements of the participation exemption are not satisfied, the capital gain is fully subject to IRES tax in the same year or, if the shares were booked as fixed financial assets in the last three financial years, over a period up to five years.

Capital gains are not subject to local income tax IRAP.

As described in Section 1, for individuals resident in Italy, beginning 1 January 2019, capital gains arising from substantial participations that are not connected to a business activity will be subject to a 26% substitute tax. Prior to that date, 58.14% of such gains are included in the general taxable base and taxed at the ordinary progressive tax rate). Capital gains on “non-qualified” participations are subject to a 26% substitute tax.

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

For companies, there is no specific fiscal advantage if the proceeds from the sale of shares are reinvested.

For individuals, non-profit entities and non-resident taxable persons Article 68(6-bis)(6-ter) provides exemption of the capital gains realized upon the disposal of both qualifying and non-qualifying participations in stock companies and partnerships, provided that:

- the owned entity has been set up for no more than seven years
- the shares sold were held for at least three years
- the capital gains realised are reinvested in another Italian resident company or partnership operating in the same business sector and incorporated within the previous three years. The new investment must be made through the subscription or acquisition of the capital of such companies and within two years from the disposal of the participations previously held

However, the amount of the exempt capital gain cannot, in any case, exceed five times the costs incurred by the issuing company during the five years preceding the disposal, for the purchase or the production of depreciable assets (intangible or tangible, excluding real estate properties) or for research and development activities.

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

Although no specific substance requirements are provided by law, great attention is paid by the tax authorities to the real substance of foreign holding companies and in some cases to the application of the tax presumptions by which a foreign company may be deemed to be tax resident in Italy.

In Circular Letter n. 6/2016 the Italian tax authorities clarified that they may apply full domestic WHT on dividends or disallow the tax treaty exemption on capital gains if foreign intermediate holding companies have:

- a light organisational structure, do not perform a real activity and do not have any decisional autonomy from a substantial view point; or
- a conduit financial structure regarding the transaction, in which a substantial correspondence between what is cashed in and out of the company is arranged

Finally, please note that in certain cases foreign companies may be deemed to be tax resident in Italy. There is a rebuttable presumption according to which a foreign company is deemed to be tax resident in Italy if (i) the foreign company directly controls an Italian resident company and (ii) the foreign company is directly or indirectly controlled by Italian residents or its Board of Directors consists mainly of Italian resident individuals.

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

The seller may need to carve out the business to be sold into a specific Newco and then sell the shares of such Newco.

This can be done through the contribution of an active business to a Newco in exchange for Newco’s shares.

Although the transaction may evidence an accounting step up of the values of the assets contributed, the tax regime remains fully neutral since:

- for the receiving company the tax cost of the assets received is the same as for the contributing company
- for the contributing company the tax cost of the Newco shares received is equal to the original tax cost of the net assets contributed

The receiving company may optionally step up the assets for tax purposes by applying the substitute tax provided by the optional regimes described in Section 4.

The contributing company may subsequently benefit from the 95% participation exemption on a sale of the Newco shares to a third party even before the one-year minimum holding period has passed, if the going concern was held for that period. The contribution in kind followed by the sale of Newco shares is explicitly ruled by the law as a non-abusive practice for income tax purposes.

From an indirect tax point of view the contribution in kind in exchange for shares is subject to a fixed amount (Euro 200) for registration tax purposes (and for cadastral/mortgage tax purposes if building are involved). If the sale of the shares occurs immediately after the contribution, the tax authorities often try to recharacterize the transaction as a sale of a going business in order to apply proportional taxes. However, as described in Section 1, according to the new article 20 of the Registration tax code, Italian tax authorities should not recharacterize a sale of shares as a sale of a going concern.

With respect to mergers and de-mergers, please note that they are fully neutral both for income tax and for indirect taxes.

## MANAGEMENT INCENTIVES

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

With respect to stock grants offered to all or certain categories of employees, there is a limited exemption up to an annual value of Euro 2.065,83 and a holding period of three years. As regards stock option plans, there is an exemption from social contribution but the benefit for the employee remains fully subject to ordinary personal taxation.

Decree Law n. 50/2017, contains new rules on “carried interests” earned by employees or directors of companies or funds. Income derived from shares, quotas or other financial instruments will be taxed as dividends or capital gains and therefore will not be taxable as income from employment if the following conditions are met:

- the total investment of employees and directors should at least be 1% of the total investment of the fund or of the equity of the company
- the profits participation is subordinated to the repayment to other shareholders of the invested capital (plus a certain hurdle rate); the same applies in case of sale of the securities
- shares, quotas of financial instruments must be held for at least 5 years unless a change of control occurs

The above rules apply to companies or funds located in Italy or in other States or territories which allow adequate exchange of information.

The new rule is applied to “carried interests” received after 24 April 2017 even if accrued in previous years.

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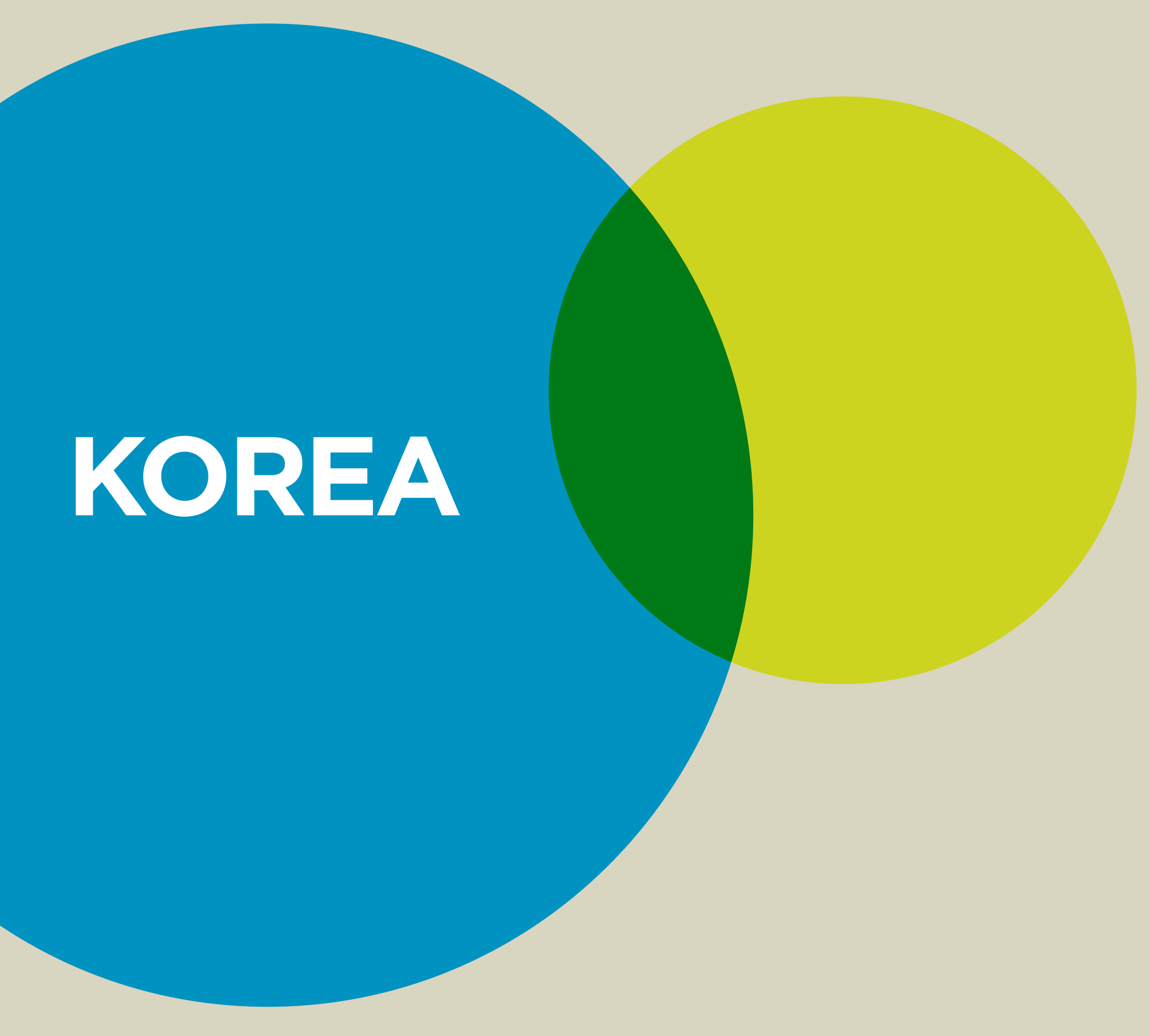
KOREA

# KOREA

## INTERNATIONAL DEVELOPMENTS

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

Korea has long been endeavoring to adopt tax policies in line with global trends and OECD guidelines, which also include BEPS, and numerous tax-related amendments were made reflecting such efforts. While there are no particular changes in the past few months, the following should be taken into consideration in M&A deals.

In cases of share deals, in principle, a transferor must pay a capital gains tax on capital gains, but a transferee is not required to pay any special tax. If the transferor is a corporation, the corporation must pay the corporation tax and as of 1 January 12018, the corporate tax rate was raised for cases where the taxable income exceeds KRW 300 billion. The changed corporate tax rate is 25% (previously 22%) on corporate income over KRW 300 billion. However, if a transferee becomes an oligopolistic shareholder (those whose total number of stocks held or total amount of investment made exceeds 50/100 of the total number of stocks issued by the relevant corporation or the total amount of investment in the relevant corporation and who exercise de facto rights to such stocks or investments. Framework Act on Local Taxes, Article 47) of the target company with assets subject to acquisition tax (e.g. real property) through transfer of existing shares, sometimes a transferee may be required to pay acquisition tax, etc.

In cases of asset deals, while a transferor must pay VAT on asset transfer gains in individual asset transfer cases (where, at the transferor or transferee's discretion, only selected assets or liabilities are transferred), no VAT is required in comprehensive asset transfer cases (where substantially all the business-related rights, assets, liabilities and employees of a company or a division of a company are transferred in a comprehensive manner, such that the nature and the continuity of the business are sustained after the transfer). However, a transferee must pay acquisition tax, etc. The National Tax Service in Korea is currently reviewing the appropriateness of transfer pricing in cases of related party M&A transactions in depth.

### 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?

In an effort to reflect the BEPS Action plan, the Korean Government has amended the relevant tax regulations including the *Adjustment of International Taxes Act*, ("AITA"), which is in line with OECD guidelines.

The relevant existing statutes provide the following provisions for taxation:

- Imposing taxes upon the actual beneficiary, not a nominal holder
- Imposing taxes associated with transfer pricing based on the arm's length price
- Interests paid to a foreign controlling shareholder will be deemed as a dividend and the relevant tax will be imposed accordingly (thin capitalization rule)
- In cases where a local resident invests in a foreign corporation having its headquarter in a country which taxes 15% or less of the actual income generated, the amount from a distributable reserve income of such foreign corporation at the end of each fiscal year belonging to the local resident will be deemed as a dividend paid to the local resident and will be taxed accordingly.
- Exchanging tax and financial information between nations

In particular, pursuant to the amendments to the AITA, a taxpayer engaged in an international transaction with a foreign related party must file both an International Transaction Schedule and an International Transaction Information Integrated Report with the competent tax authorities.  Also, the BEPS Action Plan will be reflected continually in the relevant rules and regulations in the future.

The International Transaction Information Integrated Report is consisted of an Integrated Corporate Report, an Individual Corporate Report and an Country by Country Report ("CbCR") (previously, the AITA only required an Integrated Corporate Report and an Individual Corporate Report).

The AITA states that the specific scope, method, procedure etc. of the CbCR submission will be prescribed by presidential decree (Article 11.4) and the relevant AITA Enforcement Decree (Article 21-2) was amended on 13 February 2018.

According to the AITA Enforcement Decree, in principle, if a taxpayer is a domestic parent company or a taxpayer with foreign controlling shareholders and meets elements set forth in a. or b. below, the CbCR must be filed.

**a.** Domestic parent company (ultimate parent entity of multinational enterprise group)

If the sales exceed 1,000 billion won according to its consolidated financial statements for the immediately preceding tax year

**b.** Taxpayer with foreign controlling shareholders

If the sales exceed the amounts regulated in the relevant country or 0.75 billion euro according to its consolidated financial statements for the immediately preceding tax year

**1)** the laws of the country where such controlling shareholders are located do not require CbCR submission; or

**2)** there is no tax treaty between Korea and such country etc. whereby the CbCR can be exchanged

The CbCR must include country-by-country taxpayer and related corporation revenue details, country-by-country before-tax profits and losses, country-by-country tax paid and capital, etc. The domestic parent company and domestic subsidiary/branch with the foreign controlling shareholders must submit material related to the person obligated to submit the CbCR within twelve months from the end of the business year to the tax office with jurisdiction over the place of tax payment.

## GENERAL

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

In the case of a share deal where there is a transfer of shares, while a transferor must pay a capital gains tax on capital gains from a share transfer, a transferee is not required to pay any special tax.

An asset deal is classified into two categories: an individual asset transfer and a comprehensive asset transfer.  A transferor must pay a capital gains tax and VAT on asset transfer gains in individual asset transfer cases, whereas no VAT is required in comprehensive asset transfer cases. In the case of an asset deal, a transferee must pay acquisition tax, registration tax, etc.

**a. Share deal**

**Tax advantages:**

As the target company continues to exist and the only change is a change in its shareholder structure, tax payment records of the target company may remain the same.  Furthermore, other than a small sum of tax such as a securities transaction tax, a transferee is not required to pay any special tax.

**Tax disadvantages:**

The target company's tax records may remain the same and a transferee must bear all unrecorded liabilities, contingent liabilities, etc. of the target company.

**b. Asset deal**

**Tax advantages:**

As a transferee only takes over assets of the target company, it may block out tax records, unrecorded liabilities and contingent liabilities of the target company.

**Tax disadvantages:**

In addition to a capital gains tax on asset transfer gains, there may be additional taxes such as VAT, acquisition tax, etc. as well.

## 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 stock acquisition does not change the fiscal identity of the target company. Hence, the value of the tangible and intangible assets of the target company remains the same. As such, the company's assets and liabilities will not acquire a different tax status. The target company will continue to depreciate or evaluate its assets as it did before the acquisition. Provided, however, a transferee, a new shareholder, may undertake a reevaluation of the value of the tangible and intangible assets through legal procedures. In accordance with Assets Reevaluation Act, the physical status of the company is reevaluated when there is a difference between the book value and the market value due to the rise in prices etc. However, reevaluation is exceptional and the difference according to reevaluation may not be seen as a taxable income.

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

The term goodwill refers to the recognized right having an economic value due to the target company's capacity to secure excess earnings, in comparison with other enterprises in the same industry, by having an exclusive profit opportunity such as a favorable business relationship. Generally, such goodwill is evaluated by yield capitalization approach, sales comparison approach and cost approach, and, in principle, such goodwill calculated by the said approaches is not amortized but only damages thereof are evaluated annually. In special cases such as the case of an acquisition through spin-off and merger, it may be deducted for tax purposes via amortization within a period of five years.

### 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?

In both share and asset acquisition cases, the thin capitalization rule is applicable to any borrowing from a "foreign controlling shareholder" by a domestic corporation. The scope of "foreign controlling shareholder" of a domestic corporation will be any which falls under any of the followings as of the end of each business year:

- A foreign shareholder who directly or indirectly owns 50% or more of voting shares of a domestic corporation
- A foreign corporation, 50% or more of whose voting shares are directly or indirectly owned by a foreign shareholder described above

The debt/equity ratio of 6:1 applies in the case of a foreign parent (or head office) in financial industry and the debt/equity ratio of 2:1 applies in all other cases.

If the Korean subsidiary's borrowing from a foreign controlling shareholder exceeds the thin cap rule limitation, the interest expenses for the excessive portion paid to foreign controlling shareholder will be disallowed as an interest expense deduction, and treated as dividend distribution to foreign controlling shareholder (subjecting it to dividend withholding tax). The disallowed interest expense will increase the Korean subsidiary's corporate income and the corresponding corporate income tax.

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

There are numerous strategies to push down debt in acquisitions in Korea and one of them is a merger between an acquisition vehicle and the target company. In this method, the target company takes up loans borrowed by the acquisition vehicle upon completion of the merger. Besides such merging tactic, an acquisition vehicle finances based on the target company's assets and such collateral-based debt is repaid subsequent to the acquisition in some other M&A transactions. It would be important to note that, as the directors of the target company who approved the said merger may be held liable in certain cases, a careful legal review should be done prior to implementation of such strategy in order to avoid a breach of fiduciary duty (there are many recent court cases where directors of targets were found to be liable both criminally and civilly for breaching their fiduciary duties).

Due to the thin capitalization rule limitation discussed under question 6 above, in the case where a foreign controlling shareholder wishes to merge and acquire a domestic company, the debt/equity ratio would need to be structured at the optimal level. More specifically, it would be important to avoid high levels of debt when structuring the deb/equity ratio. Diversification of the composition of investors by attracting third-party investors, domestic investors and financial investors and strategic investors that are not foreign controlling shareholders may be one of the ways to achieve this purpose.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

The following shows some tax incentives for equity financing:

- An investment tax credit may be available to certain industries such as R&D industry
- Taxes such as a corporate tax may be reduced or exempted in certain foreign investment zones
- In the case of equity financing, a limit placed on expenses for tax purposes may be increased (e.g. entertainment expenses)

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

A loss carryforward of the target company may be deducted continually in calculating a corporate tax. Specifically, in the case of a share deal, a change of control of the target company does not affect the use of a loss carryforward. In accordance with Corporate Tax Act, a loss carryforward can be used for 10 years and if the target company is a small medium sized company, it can deducted 100% of the loss carryforward amount from the taxable income. If the target company is not a small medium sized company, 60-80% of the loss carryforward amount from the taxable income.

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

According to the Korean tax law, tax investigation is conducted every five years since the status of limitations of tax is five years in Korea. To this end, it would be necessary to review statements of tax adjustments, status of tax payment, etc. for the past three or five years. Furthermore, it would also be necessary to find out whether there was any tax investigation conducted by the National Tax Service and if so, the details and outcome thereof would need to be reviewed and analyzed as well.

For instance, as corporate accounting based on K-GAAP and K-IFRS and tax accounting have some differences in accounting standards, reviewing statements of tax adjustments will enable you to verify such differences. In regard to review of the status of tax payment, as this shows a history of tax payments made by a company, it will tell you whether the company is in compliance with its tax payment obligations.

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

In the case of a share deal, there may be indirect taxes such as stamp duty, securities transaction tax, etc. and in the case of an asset deal, there may be indirect taxes such as stamp duty, VAT, etc. In the case of a share deal, the securities transaction tax is generally levied on the transferor at a rate of 0.3% on the sale of listed shares and it may be increased to 0.5% if the shares are unlisted. The stamp duty is levied on agreements relating to the creation, transfer or alteration of rights to property in Korea. The stamp tax ranges from KRW 50 to KRW 350,000 depending on the type of taxable document.

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

In both asset and share deal cases, so long as acquisition costs incurred are within the normal range, they may be recognized as expenses and tax deductible.

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

In the case of an asset deal, especially an asset deal through an individual asset transfer, VAT will be imposed. In the case of an individual asset transfer, a transferor should withhold VAT at 10% (“Sales VAT”) from a transferee and remit the collected Sales VAT to the relevant tax authority. If a transferor has paid a VAT in connection with the purchase of asset (“Purchase VAT”), the amount may be recovered by deducting the Purchase VAT from Sales VAT. A comprehensive asset transfer is exempt from VAT and no VAT is payable on the sale of shares.

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

The thin capitalization rule and VAT would need to be taken into account. Together with such, it would be necessary to prepare in advance and review the matters associated with a payment method of future dividends which will be paid out after acquisition of a domestic company by a foreign company, payment date, dividend tax, etc.

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

While a group may reorganize after an acquisition based on newly arising circumstances and tax considerations, a careful examination should be given taking into account benefits and costs thereof. Where a merged corporation is dissolved in the course of a merger, the assets of the merged corporation shall be deemed transferred to a surviving corporation. In such cases, capital gains or losses accruing from the transfer shall be included in the gross income or deductible expenses when the merged corporation calculates the amount of income for the business year in which the registration date of the merger falls and shall pay the corporate income tax.

Furthermore, in the case of qualified merger (a merger between the domestic corporations which have continued to operate their business for at least one year as of the registration date of the merger and where the value of the stocks, etc., of a surviving corporation or the parent corporation of the surviving corporation is at least 80/100 of the total costs of the merger received by the stockholders, etc., of a merged corporation in return for such merger), the capital gains or losses on a transfer may be deemed nil considering the net book value of assets as of the registration date of the merger of the merged corporation. In the case of above, the merger corporation does not pay the additional tax on the merger profit at the time of the merger since the assets of the merged corporation are considered to have been transferred as the book value. However, if the merger is not the case of qualified merger, the merger corporation shall include the profit or loss of the merger equally for 5 years. (Corporate Tax Act, Article 44, 44-2 and 44-3).

Therefore, in the case of merged corporation, the merger is distinguished from the transfer of assets and the profit or loss of the merger is not regarded as the gain or loss of the asset transfer. The taxation on profit and loss of the merger may be deferred for both qualified mergers and non-qualified mergers.

In principle, a tax grouping is not available. However, a domestic corporation that wholly controls another domestic corporation ("wholly-owning parent corporation" which holds 100% of the outstanding shares) and the other domestic corporation ("wholly controlled subsidiary") may apply the consolidated tax return system with approval of the commissioner of the competent regional tax office having jurisdiction over the place of tax payment of the wholly-owning parent corporation. (Corporate Tax Act, Article 76-8).

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

In the case where a transferee becomes an oligopolistic shareholder by acquiring the existing shares issued by the target company (if the transferee holds the existing shares issued by the target company exceeding 50%), such transferee is deemed to have acquired assets subject to acquisition tax such as real property owned by the target company by the transferee's equity ratio at the time of such share acquisition, and thus is required to pay the applicable acquisition tax. The acquisition of shares does not generally trigger acquisition tax. However, if a transferee and its affiliates collectively acquire, in aggregate, more than 50% of the shares in the target company, they will be deemed to have indirectly acquired those taxable assets through the share acquisition and will therefore be subject to deemed acquisition tax ("DAT"). The DAT payable is calculated at a rate of either 2% or 2.2% (including surtax) on the book value of the taxable assets in proportion to the percentage of shares acquired. In the event the target company fails to pay its corporate tax, VAT, etc., then such transferee who has become an oligopolistic shareholder will bear secondary tax liability to pay such applicable taxes.

Tax losses or historical tax liabilities are not transferred with the assets in an asset acquisition. In the case of an individual asset transfer, the transferee does not incur a secondary tax liability for any unpaid tax or tax liabilities of the transferor that relate to the transferred assets on the official transfer date. However, in a comprehensive asset transfer, the transferee assumes a secondary tax liability on any already fixed and determinable tax liabilities of the transferor on the official transfer date.

If the property of a transferor is insufficient to cover the money collectible by a local government in connection with the business for which tax liability has been determined before the date of business transfer in cases of business transfer and acquisition, a transferee (person who has comprehensively succeeded all rights and responsibilities concerning the business for each place of business and run a type of business the same as or similar to the business operated by the transferor at the place where the transferor has run the business) shall assume secondary tax liability for such shortage up to the limit of the price of property acquired (Framework Act on Local Taxes, Article 49).

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

Under tax law, in principle, each company is a taxpayer liable for payment of the applicable taxes, and neither fiscal unity nor tax grouping is allowed in Korea. If a consolidated tax payment is available, the losses of any corporation or any fiscal year may be recognized as deductible expenses.

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

In Korea, tax support mainly focuses on R & D itself and the tax support for IP commercialization is insufficient. Currently, a small medium sized enterprises ("SMEs") and medium-sized enterprises are allowed to reduce tax on technology transfer income and only SMEs are allowed to reduce tax on technology rental income.

For income derived by SMEs and medium-sized enterprises from the transfer of patents, etc. to a Korean national by no later than December 31, 2018, the tax amount equivalent to 50/100 of the income tax or corporation tax on the relevant income is reduced. The SMEs and medium-sized enterprises are regulated separately based on the type of industry, sales volume, and the number of employees. If a Korean national acquires a patent, etc. from another Korean national who holds the patent, etc. as a result of his/her own research and development by no later than December 31, 2018, such Korean national is entitled to deduct an amount calculated by multiplying the acquisition cost by 5/100 or 10/100 from income tax or corporation tax in the taxable year. If a SME grants a license for a patent, etc. obtained as a result of its own research and development by no later than December 31, 2018, such enterprise is entitled to an income or corporate tax reduction by the equivalent to 25/100 of the income tax or corporate tax levied on income accruing from the grant of such license (Restriction of Special Taxation Act, Article 12).

In this regard, a special tax status such as patent box is allowed in a limited way. For example, when a small medium sized company realize some revenue through a transfer of patent, it can have some benefits for tax purpose.

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

In principle, there are no 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?

A transferor of shares is required to pay capital gains tax on capital gains realized from the transfer of shares and local income tax. If the original acquisition price and transfer costs can be verified, those can be deducted by submitting the satisfactory evidence when calculating the capital gain.  If a transferor is a non-resident or a foreign company having no domestic place of business, it must report and pay the amount due by the 10th day of the second month following the month in which the day of the share transfer payment falls to the competent tax authority.  The corporate income tax rates applicable to domestic corporations and foreign corporations with a permanent establishment in Korea are 10% on corporate income of up to KRW 200 million, 20% on corporate income over KRW 200 million and up to KRW 20 billion, 22% on corporate income over KRW 20billion and up to KRW 300 billion and 25% on corporate income over KRW 300 billion.  Capital gains upon the transfer of shares, earned by foreign companies without permanent establishments in Korea, are generally subject to withholding tax at a rate equal to the lesser of either 10% of the proceeds of the sale or 20% of the capital gains made, unless those gains are exempted by the relevant tax laws or an applicable double tax treaty which Korea has entered into with the foreign shareholders' country of tax residence.  For the above corporation tax, the local income tax equivalent to 10% of the corporation tax amount will be added.

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

ere is no special benefit in respect to reinvestment other than the benefit for investment in general.  In case of investing in productivity improvement facilities, energy conservation facilities and environmental preservation facilities in accordance with the Restriction of Special Taxation Act, the amount calculated by multiplying the investment amount by a certain percentage may be deducted from the tax amount.  In addition, if a foreign investor invests in a free economic zone under the Special Act on the Designation and Operation of Foreign Investment Zones and Free Economic Zones in accordance with the Foreign Investment Promotion Act, there may be a case where a certain amount of tax is deducted for a certain period of time.  However, tax benefits for such foreign investment will be gradually abolished for the purpose of fair taxation.

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

In principle, in cases of small and medium-sized company, there are no special requirements or regulations in respect of a holding company. On the other hand, large-sized enterprises (e.g. a company with assets of KRW 500 billion) are specially regulated by the *Monopoly Regulation and Fair Trade Act*.  A holding company means a company whose main business is to control the business contents of a domestic company through the ownership of shares (including equity) and whose total assets are equal to or greater than the amount prescribed by the Presidential Decree (KRW 500 billion).  In this case, the main business standard is in accordance with Presidential Decree of Monopoly Regulation and Fair Trade Act, Article 2-1-1 and Enforcement Decree of the Monopoly Regulation and Fair Trade Act, Article 2 and the Restriction of Special Taxation Act defers the corporate tax and capital gains tax on the transfer profits that may arise when a holding company is established or conversion into a holding company (Restriction of Special Taxation Act, Article 38-2).  The holding company may deduct its corporate tax by not including the certain dividend amount received according to its holding share ratio from the subsidiary (Corporate Tax Act, Article 18-2).

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

A tax break relating to VAT (not subject to VAT for the case of comprehensive asset transfer), acquisition tax (excluded from being taxed unless an oligopoly shareholder), etc. will be given to certain mergers/spin-offs recognized under the Commercial Act, tax laws, etc., and other matters such as amortization of goodwill should be reviewed for tax purposes.

A substantial part of the merger-related taxes may be mitigated or deferred, if the merger is considered to be a qualified merger. The requirements for a qualified merger are i) both companies (i.e. surviving and dissolving companies) have engaged in business for at least one year as of the merger date, ii) where consideration is paid, at least 80% of the consideration paid to the shareholder of the dissolving company consists solely of shares in the surviving company and iii) the surviving company continues to carry out the operations of the transferred business until the end of the fiscal year of the merger. In the case of a merger, tax loss carry-forwards of the surviving company can only be used to offset profits generated from the original business of the surviving company. Similarly, the tax loss carry-forwards of the dissolved company can only be used to offset the profits from the business of the dissolved company.

Furthermore, in the case of a merger, if the merger corporation is dissolved by merger, the corporation tax reflecting the transfer profit and loss should be calculated as the corporation's assets are transferred to the merged corporation. In case of non-qualifying merger, if the merger corporation succeeds the assets of the acquired corporation, it is considered to have been transferred to the market price. In this case, the profits of merger (if the transferred amount is less than the net asset value) are equally divided into five years. In the case of qualifying merger, it is assumed that the book value is transferred and there is no transfer profit or loss. In the case of split, the same applies as in the case of the above merger.

# MANAGEMENT INCENTIVES

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

In cases where incentives such as stock options are granted to management, at each stage, careful consideration in respect to accounts and taxes should be given in dealing with matters including granting, vesting, exercising, etc. According to the Article 340-2 of Commercial Act, a company may grant an option for purchasing new shares or its own shares at a fixed price established in advance ("exercising price for stock option") to its directors etc. for a certain period time ("grant date"). If a director etc. exercises a stock option, the difference between the exercising price for stock option at the time of the exercise ("exercise day") and the actual value ("market price") of the relevant stock becomes earned income and subject to the income tax.

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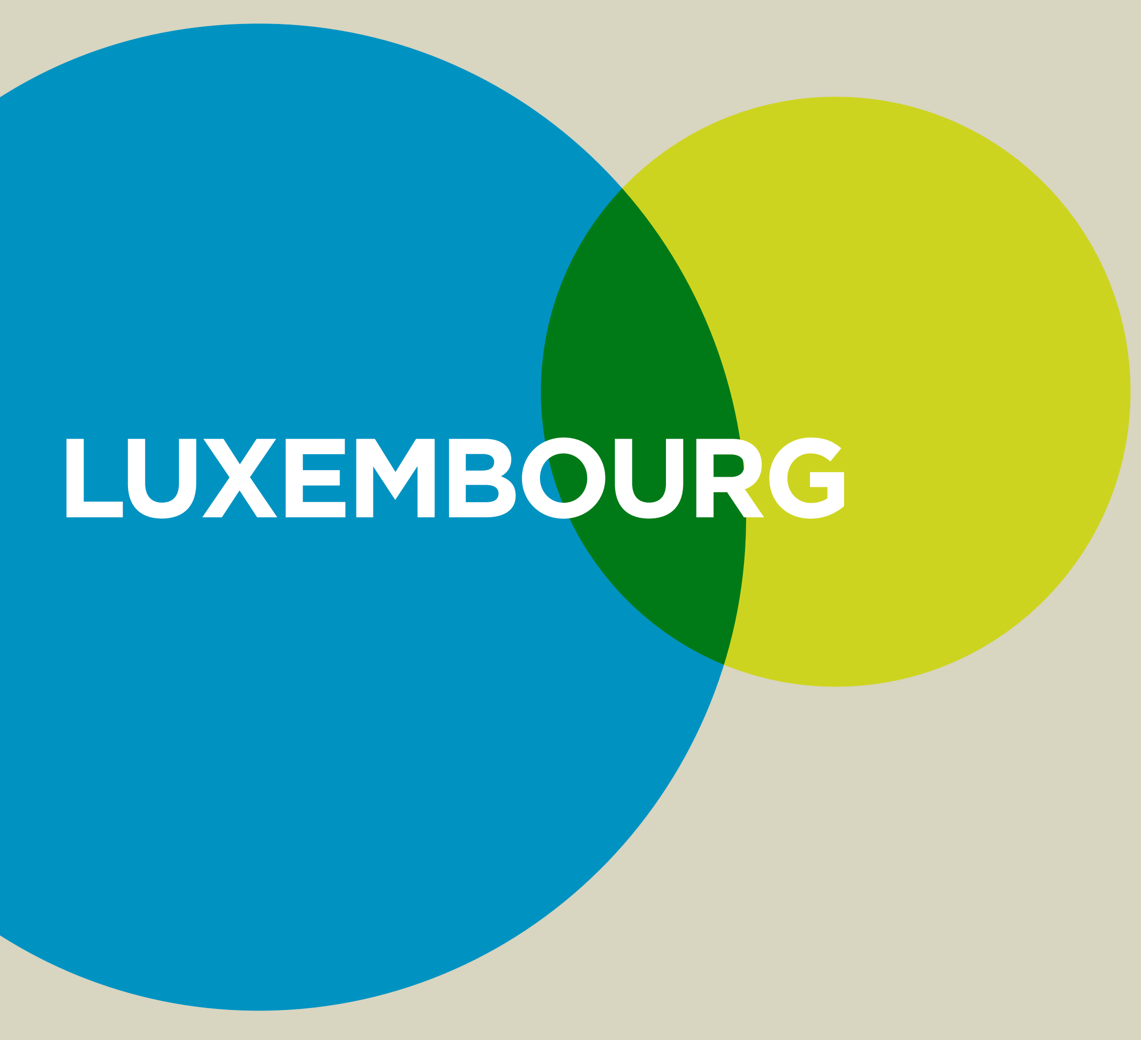
LUXEMBOURG

# LUXEMBOURG

## INTERNATIONAL DEVELOPMENTS

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

- **Corporate income tax (“CIT”) rate** – The CIT rate applicable to income exceeding EUR 30,000 has been brought down from 19% to 18% in 2018. Taking the Municipal Business Tax (“MBT”) and the solidarity surcharge into account, it brought the global corporate tax rate applicable to companies in Luxembourg-city from 27.08% in 2017 down to 26.01% in 2018
- **Minimum net wealth tax (“NWT”) increased** – The minimum NWT applicable to SOPARFIs (holding and financing companies) has been increased from EUR 3,210 to EUR 4,815 as of 2017. For the entities which are not considered as SOPARFIS, the minimum NWT ranges from EUR 535 to EUR 32,100 (depending on the total of the balance sheet)
- **Limitation to the carry forward of losses** – While tax losses generated until 2016 remain tax deductible without any limitation, the carry forward of tax losses generated as from 2017 is limited to 17 years. The oldest losses will have to be used first. This new limitation applies for both CIT and MBT purposes
- **0.24% tax abolished** – Since 2017, deeds including the assignment of receivables are no longer subject to the 0.24% registration duty.

### 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 DIRECTIVE?

Luxembourg has implemented into its internal law Directive 2014/86/EU of 8 July 2014 which amends the EU Parent Subsidiary regime so as to stop situations of double non-taxation created by the use of certain hybrid instruments and Directive 2015/121 of 27 January 2015 which introduces a de minimis General Anti-Abuse Rule (GAAR).

Luxembourg is supportive of the implementation of BEPS recommendations and has already implemented the following BEPS-related EU Directives:

- Directive EU 2015/2376 on automatic exchange of information on tax rulings
- EU Directive 2016/881 of 25 May 2016 which extends administrative cooperation in tax matters to Country-by-Country (CbC) reporting. Luxembourg has not implemented yet the anti-tax avoidance directives (ATAD) but is expected to do so as any other EU Member State in order to make sure that the measures of ATAD become effective in accordance with the timing requirements set by the directive

**The Multilateral Instrument (MLI)**

On 7 June 2017, Luxembourg signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). Luxembourg has not started the ratification process of the MLI yet.

## GENERAL

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

**A) Share deal**

**Tax advantages:** A share deal in Luxembourg enables the target company to continue to carry forward its losses. However, losses incurred as from 2017 can only be carried forward over 17 years. There are no taxes levied on a share sale unless the securities that are sold are those in a Luxembourg tax transparent entity (e.g. société civile) holding at least one Luxembourg real estate asset. The duties applicable upon disposal of certain assets (essentially real estate) in a share deal are lower than in an asset deal.

**Tax disadvantages:** In a share deal, the assets in the company sold will not be revaluated at fair market value.

**B) Asset deal**

**Tax advantages:** In an asset deal, the purchaser will dispose of a higher basis for depreciation in the future.

Tax disadvantages: A first disadvantage of the asset deal is the fact that a financial participation cannot be amortised. Another disadvantage of asset deals is the relatively high Luxembourg registration duty applicable on the disposal of certain assets (essentially real estate) where registration is mandatory. The registration duties in an asset deal are higher than in a share deal. Finally, in an asset deal, the target's losses may not be carried forward by the purchaser.

## 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?

In principle, in share deals, it is not possible to perform a step-up in value in Luxembourg. However, in certain cases, it is possible to perform internal restructurings allowing for a step-up in value and tax deferrals.

### 5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL IN YOUR COUNTRY?

In principle, goodwill may be depreciated for tax purposes over a 10-year period.

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

Luxembourg has three types of limitation to the deductibility of interest on borrowings: (i) limitation related to the purpose of the expense, (ii) limitation based on transfer pricing rules and (iii) limitation based on the recharacterisation of the interest expense into a dividend.

**Limitation related to the purpose of the expense**

Only expenses incurred exclusively for business purposes are tax-deductible. The purpose of this rule is to draw a line between operational and personal expenses (a comment relevant mostly for individual commercial enterprises). Thus, interest payments are deductible if the debt is contracted in the company's interest. One limitation to this rule is that expenses which are economically connected to tax-exempt income are not deductible. Based on this rule, limitations on interest deduction apply to an exempt dividend, income derived through a foreign permanent establishment or exempt capital gains on the disposal of shares.

**Limitation based on transfer pricing rules**

Transfer pricing principles are defined in articles 56, 56bis and 164(3) of the Luxembourg income tax law (“LITL”).

Article 56 LITL provides a legal basis for transfer pricing adjustments where associated enterprises deviate from the arm’s length standard. In other words, where a Luxembourg company shifts advantages to another group company, the Luxembourg tax authorities may increase the company’s taxable income (upward adjustment). Conversely, where a Luxembourg company receives an advantage from an associated company, the taxable income of the Luxembourg company may be reduced by a downward adjustment. Article 56 LITL has been amended in 2015 so as to formalize the application of the arm’s length principle under Luxembourg tax law.

In 2017, a new article 56bis LITL has been introduced, which complements Article 56 of the LITL, formalizes the authoritative nature of the OECD TP Guidelines and provides for some definitions and guiding principles in relation to the application of the arm’s length principle.

On 27 December 2016 the Luxembourg tax authorities released a new circular on the tax treatment intra-group financing activities. The new circular followed the introduction of the new article 56bis LITL and provides guidance on the practical application of the arm’s length principle to intra-group financing activities, ensuring consistency with all international transfer pricing standards.

The new circular replaces Circular 164/2 of 28 January 2011 and Circular 164/2bis of 8 April 2011 and became applicable as from 1 January 2017. Advance Pricing Agreements which have been granted in accordance with the “old” rules are no longer valid.

Finally, Article 164(3) LITL provides that hidden distributions (i.e., direct or indirect advantages granted by the company to its shareholder which, absent the shareholding relationship, would otherwise not have been granted) are non-deductible from the taxable basis of the company.

**Limitation based on the recharacterisation of the interest expense into a dividend**

Based on the “substance over form” approach, an instrument is qualified as debt or equity based on its economic nature - that is, not necessarily based on its legal qualification. If an instrument is requalified from debt into equity, the proceeds are no longer considered as interest but are instead considered as dividends for tax purposes and the payment will not be tax-deductible.

Article 164(2) LITL furthermore includes specific situations where interest might be recharacterised into dividends. Distributions of any kind made to holders of shares, founder’s shares, parts bénéficiaires, parts de jouissance or any other titles, including variable interest bonds entitling the holder to a participation in the annual profits or the liquidation proceeds, are to be treated as dividend distributions and thus non-deductible.

**Limitation based on the interest limitation rule provided in ATAD**

So far, no announcement has been made on the way Luxembourg will implement the interest deduction limitation rule provided in ATAD. However, following the implementation of this rule into Luxembourg internal law, additional limitations to the deductibility of interest expenses will apply as from 1 January 2019.

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

Tax consolidation between the profit-making entity and the debtor entity may be one way to push down debt on acquisitions.

Another strategy is to form a domestic holding company which, in turn, forms a temporary merger subsidiary used to perform the acquisition. Upon the consummation of the transaction, the merger subsidiary is merged into the target, and the proceeds are disbursed to the selling shareholders in exchange for their stock. Financing is arranged for the merger subsidiary, which is subsequently assumed by the target as the successor to the merger. Financing may come directly from third parties or internally through back-to-back loans.

(For specific interest deductibility conditions in the context of intragroup financing activity, please refer to section "Limitations to the deductibility of interest on borrowings" above.). If the acquisition is initially done without using debt at the local level, it can subsequently be introduced in Luxembourg through a variety of means. Direct financing of the target and a distribution of the proceeds may be one way.

Causing the target to be sold to a newly formed domestic subsidiary of the foreign parent for a note may be another. Caution should be exercised, however, as such transactions may create a dividend, giving rise to withholding tax.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In Luxembourg, there are no specific tax incentives regarding the equity funding of assets.

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

In an asset deal, losses of the target may not be carried forward by the purchaser.

In a share deal, the target company continues to carry forward its losses for an unlimited period of time. However, losses incurred as from 2017 can only be carried forward over 17 years. Existing losses of the target cannot be used through a tax consolidation.

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

In addition to the general request of information, the following documents should be reviewed in the frame of a tax due diligence of a Luxembourg company:

- Tax assessments issued by the Luxembourg tax authorities in order to see whether the tax losses carried forward of the company can be considered as final or whether they are only based on the automatic assessment made by the tax authorities upon receipt of the tax return
- Tax statements issued by the LTA
- Advance tax agreement and/or advance pricing agreement granted by the LTA; and
- Transfer pricing studies prepared (e.g. for intra-group activities)

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

Since 2009, Luxembourg companies are no longer subject to the 0.5% capital duty that was formerly levied on the value of the assets contributed to the company upon incorporation and capital increases.

Transfers made in the context of a corporate restructuring (i.e., contributions of all assets and liabilities, contributions of one or more branches of activities and contributions of all assets and liabilities of the 100%-held subsidiary) are exempt from proportional registration duties. The transfers must, however, be mainly remunerated (i.e., with more than 50%) with securities that represent share capital of the companies involved.

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

Acquisition costs are in principle reported in the balance sheet, as part of the acquisition price of the asset. Therefore, acquisition costs can be depreciated. If the acquisition costs are not recorded as "fixed assets", there is no limitation to their deductibility

However, specific rules apply to the acquisition of a shareholding: if the acquisition costs of the shareholding are recorded in the balance sheet as part of the acquisition price, they cannot be depreciated given that the shareholding is an asset which cannot be depreciated. If, instead, the costs are recorded as an expense in the P&L account, they will be deductible in a first step but subject to the recapture rule. According to this rule, upon disposal of the shareholding, any capital gains realized will remain subject to tax up to the sum of all related expenses that were deducted for tax purposes in the year of disposal or in previous financial years. However, the taxable part of the gain can be offset against the tax losses carried forward which were generated by these expenses.

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

Within the framework of M&A transactions, a specific attention must be paid on whether the deal is structured as an asset deal or a share deal.

Except under some particular cases, for both asset deal and share deal (in case of VAT exempt transaction or transaction outside of the scope of VAT), the input VAT incurred on acquisition costs should in principle not be recoverable.

Therefore, it is important at an early stage of the deal to elaborate the cost structure in such a way that an optimal recovery of input VAT could be achieved.

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

Foreign companies acquiring Luxembourg resident companies or assets should pay attention to the following:

- Provided no double tax treaty which grants the exclusive taxation right to the country of the non-resident investor applies, capital gains derived from the sale of a substantial participation (i.e. more than 10% of the shares) in a Luxembourg company are taxable in Luxembourg if the period between the acquisition and the disposal is less or equal to 6 months;
- Dividends distributed by a Luxembourg resident company to the foreign acquiring company are in principle subject to a 15% withholding tax in Luxembourg, unless the foreign acquiring company is eligible to the Luxembourg withholding tax exemption regime, or unless it benefits from an exemption or reduced rate based on a double tax treaty;
- The taxation of capital gains realised upon transfers of a Luxembourg company, a Luxembourg permanent establishment or Luxembourg business assets to another EU Member State, to a country of the European Economic Area ("EEA") or to countries with which Luxembourg has concluded either a Double Tax Treaty with exchange of information provisions in line with the OECD Model Tax Convention or a tax information exchange agreement can be deferred upon request until the effective realisation of the gain.

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

Luxembourg's corporate income tax law provides for a special tax-neutral regime applicable to certain qualifying corporate restructurings (such as mergers, demergers, etc.), based on the tax regime of the EU Council Directive 90/434/EEC (as further amended) on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states, known as the EU Merger Directive.

In Luxembourg, tax-neutral mergers are possible for purely domestic reorganisations or if a Luxembourg company transfers its assets to another EU company in the course of a merger or demerger involving a company from another EU member state. A cash payment of a maximum of 10% of the nominal value of the shares

allocated to the shareholders of the absorbed company is allowed. The merger is tax-neutral only to the extent Luxembourg retains the right to tax the deferred gain in the future, which generally means that a permanent establishment has to be maintained in Luxembourg. The transfer of permanent establishments located outside Luxembourg is also covered: if the permanent establishment is located in an EU treaty country, Luxembourg exempts the transfer of this permanent establishment by a Luxembourg company.

In the absence of a tax treaty between said country and Luxembourg, Luxembourg retains the right to tax the gain on the transfer of this permanent establishment. If the absorbing company has a participation in the absorbed company which is cancelled at the time of the merger, this participation is deemed to be sold at fair market value, even if the merger is realised in a tax-neutral manner. A tax exemption is available based on the participation exemption regime (see question 18) when the absorbing company holds a qualifying participation of 10%, or has an acquisition value of at least EUR1.2 million in the absorbed company for at least 12 months. In addition, the gain realised upon the cancellation of the participation in the absorbed company is tax-exempt if the absorbing company has had a participation of at least 10% in its subsidiary, without any holding period requirement.

A tax-neutral demerger is possible for purely domestic reorganisations under the condition that all or part of the assets of a company are transferred to several Luxembourg-resident capital companies in the course of the demerger.

Under similar conditions, a tax-neutral demerger is available in an EU context.

The partners or shareholders of the demerged company have to receive shares in the beneficiary companies on a basis which is proportional to their participation in the demerged company. A cash payment not exceeding 10% of the nominal value of the shares allocated to the shareholders of the absorbed company is allowed. The assets transferred have to constitute an enterprise or a branch of activity.

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

Contributions of real estate assets situated in Luxembourg are subject to the following registration duties:

- Contributions remunerated by shares are subject to a 0.6% registration duty plus a 0.5% transcription tax
- Contributions remunerated by other means than shares are subject to a 6% registration duty plus a 1% transcription tax (4% for Luxembourg city)

Where a Luxembourg company acquires foreign real estate directly or through a local real estate company, the double tax treaty provisions should be checked carefully together with the local tax regime to analyse how the income from the investment will qualify and where it will be taxed. Some treaties entail specific provisions applicable to income from real estate entities as well as to capital gains realised upon the sale of shares and other interests in real estate companies. These types of income might either be considered as capital gain or as real estate income and may be taxable either in the country where the real estate is located or in the country of residence of the beneficial owner of the income.

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

Horizontal and vertical tax consolidation regimes are available in Luxembourg for CIT and MBT purposes. The consolidation should exist for at least 5 fiscal years. Each consolidated company files its own tax returns. In addition, the integrating entity files a single tax return combining individual results of the group with corrections to eliminate from the taxable result of the group double deductions or double taxations resulting from the application of the consolidation regime. However, intercompany operations do not need to be eliminated under the Luxembourg fiscal integration regime. Losses incurred before the fiscal integration can be used during the

integration only by the integrated entity to the extent that the company that incurred them realizes a profit and only up to the amount of profit realized by that company. Losses incurred during the fiscal integration can only be used by the integrating entity. In case the consolidation is broken before the 5-year period has elapsed, the entities part of the consolidation will be retroactively taxed on a stand-alone basis.

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

Since tax year 2018, Luxembourg taxpayers are able to benefit from an 80% exemption regime applicable to the following income related to patents and copyrighted software: income received for the right to use the qualifying IP right; income directly linked to the qualifying IP asset and incorporated in the sale price of a product or service as well as income realised on the disposal of such IP rights. In addition, IP assets which qualify for the 80% (corporate) income tax exemption are 100% exempt from NWT. The regime introduced in 2018 is compliant with the so-called "modified nexus approach" defined in the OECD report on Action 5 of the BEPS Action Plan according to which IP regimes should only provide benefits to taxpayers that engage in R&D. The new regime replaces the former regime, which had a broader scope of application (since more IP rights were covered) and which had to be repealed as of 30 June 2016 since it was not in line with the modified nexus approach. Taxpayers that benefited from the old regime at the time of the repeal can still benefit from the old regime during a transitory period which will end on 30 June 2021.

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

No. If the intangible falls within the scope of IP rights covered by the new IP regime, the gain may even benefit from the partial exemption regime provided by the IP regime.

# SELL-SIDE

## 20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains are in principle fully subject to corporate income tax and municipal business tax at a rate of currently 26.01% as of 2018 in Luxembourg-city. Subject to conditions, capital gains can be exempt based on the Luxembourg participation exemption regime.

**Participation exemption regime**

Capital gains deriving from the sale of shares held in a subsidiary are fully exempt from CIT and MBT in Luxembourg, provided the following conditions are met:

The beneficiary is a Luxembourg fully taxable company, which holds a shareholding in:

- an undertaking resident of the EU covered by article 2 of the Council Directive 2011/96/EU; or
- a Luxembourg resident capital company fully liable to Luxembourg tax; or
- a non-resident company liable to a tax corresponding to Luxembourg corporate income tax. For that purpose, a taxation of at least 9% (i.e. half of the CIT rate) on a basis comparable to the Luxembourg basis is usually required by the Luxembourg tax authorities

At the date the capital gain is realised, the holder has held or commits itself to hold for an uninterrupted period of at least 12 months a direct and continuous shareholding of at least 10% in the capital of the subsidiary or of a minimum acquisition price of EUR 6 million.

The beneficiary may hold its participation through a tax transparent entity as defined in article 175(1) of LITL. In such case, the underlying shareholding will be valued according to the proportion held in the net assets of the tax transparent entity.

Based on the recapture rule, capital gains will remain subject to tax up to the sum of all related expenses that were deducted for tax purposes in the year of disposal or in previous financial years. Expenses include, for instance, interest expenses on loans used to purchase the shares or any write-downs of the participation. However, the amount is usually offset by the tax losses carried forward previously incurred by the shareholder.

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

Luxembourg tax law enables a Luxembourg company to defer a capital gain realised on a corporate reorganisation if an amount corresponding to the sale proceeds of a fixed asset realised is reinvested into another fixed asset, including substantial participations.

Upon the sale of such participations, the participation exemption is, however, denied. The exemption is available for shares acquired as a contribution of assets or for shares exchanged in the course of a share or asset merger. If shares not forming part of a participation qualifying for the dividend and/or capital gains exemption are exchanged for a participation which meets the participation threshold for such exemptions, the participation exemption will nevertheless be denied for a period of five years, to avoid reorganisations which are exclusively tax driven, i.e. driven by the benefit of the participation exemption regime.

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

From a Luxembourg tax perspective, a company is considered tax resident in Luxembourg if its statutory seat or its central administration (i.e., place of effective management) is located in Luxembourg. Luxembourg tax law does not include any additional specific substance requirements and in practice, the needs in terms of substance requirements are in most cases driven by the expectations of the foreign jurisdictions involved in the structure, meaning that the appropriate level of substance has to be determined on a case by case basis. However, in 2 specific situations (financing activities and application of the parent-subsidiary regime in an EU context, as explained below), additional economic substance may be required from a Luxembourg point of view.

Luxembourg does not have specific requirements regarding the substance of the foreign holding entities. However, when it comes to the application of the exemption of dividends received from/distributed to EU subsidiaries, the General Anti-Abuse Rule introduced by the Directive 2014/86/EU of 8 July 2014 applies. In this case, the substance should be sufficient at all levels of the holding structure, having regard to the activities performed. Otherwise, the exemption may be denied based on the fact that the dividend would be considered as being part of an arrangement or series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Parent-Subsidiary Directive, is not genuine having regard to all relevant facts and circumstances.

Finally, in anticipation of the implementation of the general anti-abuse rule included in ATAD as from 1 January 2019 as well as the upcoming entry into force of the MLI which includes a Principle Purposes Test (PPT), attention has to be paid to economic substance for any kind of transactions or investments in a cross-border context.

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

The Luxembourg regime is widely inspired by the European directives. Based on article 170(1) of the LITL, the merger of two Luxembourg companies should be considered as a deemed liquidation of the absorbed company and as such should trigger the realization of all assets and liabilities of the absorbed company at fair market value (article 169 of the LITL), i.e. all latent capital gains should be disclosed and accordingly subject to tax in Luxembourg.

Provided that the following conditions are met, mergers and spin-offs may however be conducted in tax neutrality:

- the absorbing company must be a fully taxable Luxembourg company (or a resident company in an EU member State)
- all the assets and liabilities of the absorbed company must be transferred as a result and at the time of a dissolution without liquidation
- the transaction must be performed by way of the cancellation of the shareholding held by both companies and
- the latent capital gains transferred to the absorbing company must be subject to Luxembourg taxation in the future

Based on the Luxembourg VAT Law, the transfer of a business as a going concern is not subject to VAT (17 %) provided certain conditions are met. Following the transfer, the new owner should be in possession of a business that can be operated as such.

## MANAGEMENT INCENTIVES

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

Capital gains realized by non-resident managers on the sale of a shareholding in a Luxembourg company are not taxable in Luxembourg, provided that the manager holds less than 10% in the Luxembourg company or the sale is performed more than 6 months following the acquisition of the shares.

Capital gains realized by Luxembourg resident managers on the sale of shareholdings are exempt if the manager holds less than 10% in the company and the sale is performed more than 6 months following the acquisition of the shares. In case of a sale after more than 6 months of a shareholding of 10% or more,  Luxembourg resident managers benefit from a EUR 50.000 deduction and a taxation of the gain at a reduced rate (½ of the applicable income tax rate - Maximum of 22,89% for 2018).

## FOR MORE INFORMATION CONTACT:

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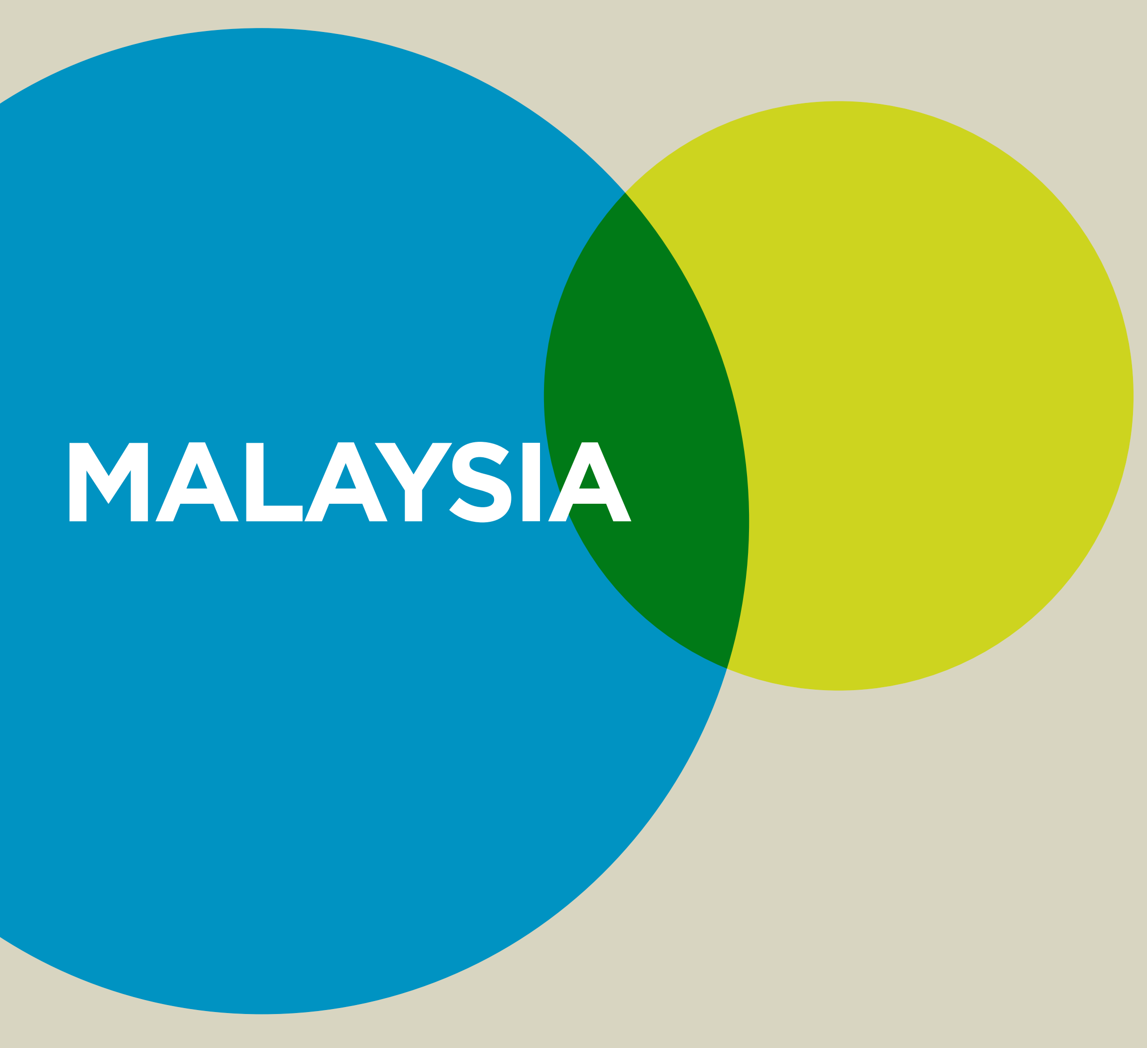

# MALAYSIA

# MALAYSIA

## INTERNATIONAL DEVELOPMENTS

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

There are no recent developments in this aspect. For further information on Malaysia's compliance with BEPS initiative, please see the comments in question 2 below.

### 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?

Malaysia supports the BEPS initiative and is committed to review and update the local tax legislation to ensure that it is in line with the BEPS Actions. In March 2017, Malaysia joined the Inclusive Framework on BEPS as a BEPS Associate and is committed to the implementation of 4 minimum standards, i.e. countering harmful tax practices (BEPS Action 5), prevention of treaty abuse (BEPS Action 6), implementation of country-by-country (CbC) reporting (BEPS Action 13) and enhancing dispute resolution mechanisms (BEPS Action 14). In addition, in line with BEPS Action 4, Earnings Stripping Rules ("ESR") was introduced and would come into effect from 1 January 2019 onwards.

At present, the Ministry of Finance and the Malaysian Inland Revenue Board have not provided further details on the implementation of the four minimum standards, except for the implementation of Action 13. The rules with respect of the filing of CbC reports and the exchange of CbC reports with other jurisdictions were issued by the Ministry of Finance in December 2016. Various amendments were subsequently made to the rules with respect of the filing of CbC reports under the Income Tax (Country-by-Country Reporting) (Amendment) Rules 2017, which were gazetted on 19 December 2017. In addition, Malaysia is also one of the participating countries with respect to the development of a multilateral instrument (in accordance with BEPS Action 15) to expedite and streamline the implementation of the measures developed to address BEPS, through effecting amendments to bilateral tax treaties.

## GENERAL

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

In a share deal, where the acquiring company buys the shares in the target company, the target company continues to benefit from claiming capital allowance (tax depreciation) on qualifying assets and any unabsorbed tax losses or unabsorbed capital allowances can be carried forward to future years, subject to the "substantial change in shareholders" provision as explained below.

Where there is a substantial change (more than 50%) in the shareholders of a company, any unabsorbed tax losses or unabsorbed capital allowances cannot be carried forward to future years. However, this provision does not apply to active companies, based on a concession granted by the Minister of Finance.

If the target company has been granted tax incentives, the incentives can continue to be enjoyed by the target company unless there is an approval condition attached to changes in shareholders.

In an asset deal, where the acquiring company buys certain assets from the selling company, the selling company will be subject to a tax adjustment by way of a balancing allowance or a balancing charge where capital allowances have been claimed on the acquired asset. A balancing charge (taxable item) arises where the sales proceeds for the asset exceed its tax residual value. Conversely, a balance allowance (deductible item)

arises where the sales proceeds is lower than the tax residual value. However, this provision does not apply in a "controlled transfer" where the seller has control over the acquirer or vice versa, or where the seller and the acquirer are controlled by another person. In a "controlled transfer", no balancing charge or balancing allowance will arise to the seller and the acquirer can continue to claim capital allowances on the transferred asset, subject to the tax residual value of the asset.

Gains arising from the sale of shares in a real property company or real property (for example, land and buildings) will be subject to real property gains tax. A "real property company" is defined as a controlled company that owns real property or shares in real property companies or both, whereby the market value of the real property or shares in real property companies or both is not less than 75% of the value of the company's total tangible assets. In this regard, a "controlled company" is a company having not more than 50 members and controlled by not more than five persons.

From a stamp duty perspective, the sale of shares in a Malaysian incorporated company will be subject to stamp duty at the rate of 0.3%. Sale of assets such as land and receivables will attract stamp duty at rates ranging from 1% to 3%. Nevertheless, relief from stamp duty is available for reconstructions or amalgamation of companies, or for transfer of property between associated companies, subject to fulfilling certain conditions.

As for goods and services tax (GST), a transfer of undertaking or asset is regarded as a taxable supply unless the conditions of a transfer as a going concern are met. The transfer of shares is exempt from GST. Note that effective from 1 June 2018, all taxable supplies have been zero-rated and the GST legislation is expected to be repealed shortly.

## 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?

There are no provisions in the Malaysian Income Tax Act that provide a step-up in the value of the underlying assets in a share deal.

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

Malaysia does not have any particular rules for amortization of goodwill. Goodwill is not tax deductible and does not qualify for capital allowances.

### 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?

Interest cost is deductible against gross business income if it relates to borrowings used for working capital or laid out on assets used or held for the production of gross income from the business. The deductibility of interest is subject to restriction if the loan on which the interest relates, was used directly or indirectly for non-trade purposes (e.g. investment in movable or immovable property or loans to others). The amount of interest restricted can be claimed against income from the investment, if any (e.g. rental or interest income).

Under the single tier system, dividends received by the shareholders are exempt from tax. In line with this, any expenses, including interest on borrowings to finance the share acquisition will be "lost" as such expenses are to be disregarded for tax purposes.

The thin capitalisation rule has been revoked and will be replaced by the Earning Stripping Rules ("ESR"), proposed to take effect from 1 January 2019. Under ESR, it has been proposed that the deduction for interest on loans between related companies within the same group will be limited to a ratio, ranging from 10% to 30%,

of a company's Earnings Before Interest and Taxes ("EBIT") or Earnings Before Interest, Tax, Depreciation and Amortisation ("EBITDA"). At present, the ESR has not been legislated as yet and there are no guidelines issued by the tax authorities on the application of this rule with regard to the specific ratio and basis i.e. EBIT or EBITDA.

It should be noted that payment of interest to non-resident lenders is subject to withholding tax at the rate of 15% under the domestic tax legislation.

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

Where the acquiring company pushes down a debt that has been used to finance the acquisition of shares in a target company, the target company will not be allowed a deduction for interest on the borrowings obtained to repay part of its share capital. Also, since single tier dividends are tax exempt in the hands of the shareholder, the acquiring company will not enjoy a tax deduction on interest on borrowings to finance the share acquisition.

It would be more tax efficient if the undertaking, rather than the shares, of the target company is acquired by a local acquiring company. In this regard, the acquiring company would be entitled to claim a deduction for the interest on borrowings obtained to fund the acquisition of the undertaking.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There is no specific tax incentive for equity financing.

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

The unabsorbed tax losses of the target company brought forward from previous years will be available to offset against future business income of the target company. As a concession, companies (except dormant companies) are allowed to carry forward unabsorbed tax losses even when there is a substantial change (more than 50%) in the shareholders. The unabsorbed tax losses are not allowed to be transferred to the acquiring company.

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

For corporate income tax purposes, the statute of limitation is 5 years whilst the statute of limitation for transfer pricing is 7 years. The acquiring company should review any tax incentives granted by the Malaysian government to the target company, particularly on the qualifying conditions and tax incentive period.

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

Malaysia imposes stamp duty on chargeable instruments executed on certain transactions. The transfer of shares will attract stamp duty at the rate of 0.3% on the consideration paid or market value of the shares, whichever is the higher.

However, stamp duty relief is available for the following circumstances, subject to meeting the pre-requisite conditions:

- If the acquisition of shares is in connection with a scheme of amalgamation or reconstruction of companies and where the consideration comprises substantially of shares in the transferee company; or
- If the shares are transferred between "associated companies". The transferor and transferee are "associated" if the transferor is the beneficial owner (either directly or indirectly) of not less than 90% of the issued share capital of the transferee or vice versa, or a third company is the beneficial owner (directly or indirectly) of not less than 90% of the issued share capital of the transferor and transferee respectively.

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

Generally, no deduction is allowed for costs relating to the acquisition such as consultancy fees, legal fees or other professional fees. The cost of acquiring the shares is not deductible. The cost of assets acquired will qualify for capital allowances if it is a qualifying plant expenditure.

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

The goods and services tax (GST) legislation will be repealed at a future date. In the interim, all taxable supplies have been zero-rated with effect from 1 June 2018. In place of GST, a sales and service tax (SST) regime will be introduced. However, SST should not apply to a transfer of asset or shares.

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

Malaysia does not impose withholding tax on dividends. However, there is withholding tax on interest, royalty and service fees paid to non-residents. The withholding tax rate may be reduced by the relevant tax treaty and hence, consideration should be given to this issue in the structuring of cross border investments into Malaysia.

There is no capital gains tax regime except for real property gains tax which is applicable to gains on the disposal of real property or shares in real property companies.

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

There are no legal provisions that provide for mergers of companies. Reconstruction or amalgamation of companies can be achieved by transferring the business undertaking or shares of one company to another. There may be stamp duty and real property gains tax implications associated with these transfers but exemptions are available, subject to conditions. Transfer of fixed assets between related companies are subject to the control transfer provision, as explained in question 3.

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

The target company will be regarded as a real property company (RPC) if it owns real property (real estate) or shares in RPC or both, whereby the market value of these is not less than 75% of the value of its total tangible assets. Gains arising from the sale of RPC shares are subject to real property gains tax (RPGT)]. The sale of the real estate is also subject to RPGT. The RPGT payable may be different between a sale of the real estate and shares in a RPC due to the prescribed computational rules.

Besides RPGT, the sale of real estate and shares is subject to stamp duty. The stamp duty payable on shares is 0.3% on the consideration paid or market value of the shares, whichever is the higher whilst stamp duty payable on the sale of real estate is 1% to 3% on the sale consideration or market value, whichever is the higher.

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

Group relief is available in relation to tax losses, subject to various conditions. Under the group relief, a company resident and incorporated in Malaysia may surrender up to 70% of its adjusted loss in the current year to one or more related companies that are resident and incorporated in Malaysia. The surrendering and claimant companies are related if at least 70% of the paid-up capital of the surrendering company is owned (directly or indirectly) by the claimant company or vice versa, or at least 70% of the paid up capital of the surrendering company and claimant company is owned (directly or indirectly) by another company resident and incorporated in Malaysia.

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

Labuan is Malaysia's international financial centre and offers a preferential tax regime for Labuan incorporated entities undertaking Labuan business activities. Labuan trading activities are taxed at a preferential rate of 3% of the net audited profits or a tax of RM20,000, depending on the election made by a Labuan entity. Income from non-trading activities such as the holding of investment in securities, stock, shares, deposits or any other properties are tax exempt. In addition, withholding tax does not apply to certain payments made by a Labuan entity to non-residents such as royalties, interest, dividend, lease rentals and service fees.

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

There are no adverse tax consequences on the transfer of ownership of intangibles provided that the gains arising from the transfer are not considered trading gains derived from Malaysia.

# 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?

Malaysia does not have a capital gains tax regime except for real property gains tax (RPGT). RPGT is imposed on gains on disposals of real property located in Malaysia or shares in a real property company (RPC), as defined above. Where the disposer is a company, the RPGT rate is 30% if the disposal takes place within 3 years from the date of acquisition of the chargeable asset, 20% if the disposal takes place in the fourth year after the date of acquisition and 5% if the disposal takes place in the fifth year after the date of acquisition or thereafter.

Where the prior approval from the Malaysian Inland Revenue Board is obtained, exemption from RPGT is available in the case of a transfer of a chargeable asset between companies in the same group to bring about greater efficiency in operation, for a consideration consisting of shares in the company or substantially of shares in the company and the balance in cash.

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

There is no fiscal advantage if the proceeds from the sale of shares are reinvested.

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

There are no specific local substance requirements for foreign holding companies. In order to enjoy reliefs accorded under Double Tax Agreements (DTAs), the Malaysian Inland Revenue Board in practice requires Malaysian taxpayers to maintain a tax resident certificate of the foreign company to demonstrate that a particular DTA is applicable. The substance over form approach is generally observed and the foreign company should be the beneficial owner of any payments received from Malaysian subsidiaries or group companies. However, Malaysia does not levy withholding tax on dividends. Hence, from a dividend repatriation perspective, the location of foreign holding companies is not significant. The Ministry of Finance and the Malaysian Inland Revenue Board have not announced any changes in this respect to take into account the BEPS initiative. However, it is believed that Malaysia, as a BEPS Associate, will review and update the local tax legislation to ensure that it is in line with the relevant BEPS Actions over time.

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

In relation to a transfer of business or real property, consideration needs to be given to the real property gains tax (RPGT), stamp duty and GST implications. Exemption from RPGT and stamp duty relief may be available if the pre-requisite conditions are met

## MANAGEMENT INCENTIVES

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

Some companies offer stock options and other types of share award schemes to senior employees as part of employees' reward and retention incentives. Benefits arising from stock options/share plans are taxable at exercise or vesting date, whichever is the case. The taxable value is the difference between the lower of the market value of the shares on exercisable and exercise date, less the offer price. Any gain arising from a subsequent disposal of the shares is not taxable. Where treasury shares are offered to employees under a stock option or share award scheme, the company is entitled to claim a tax deduction on cost incurred in acquiring the treasury shares.

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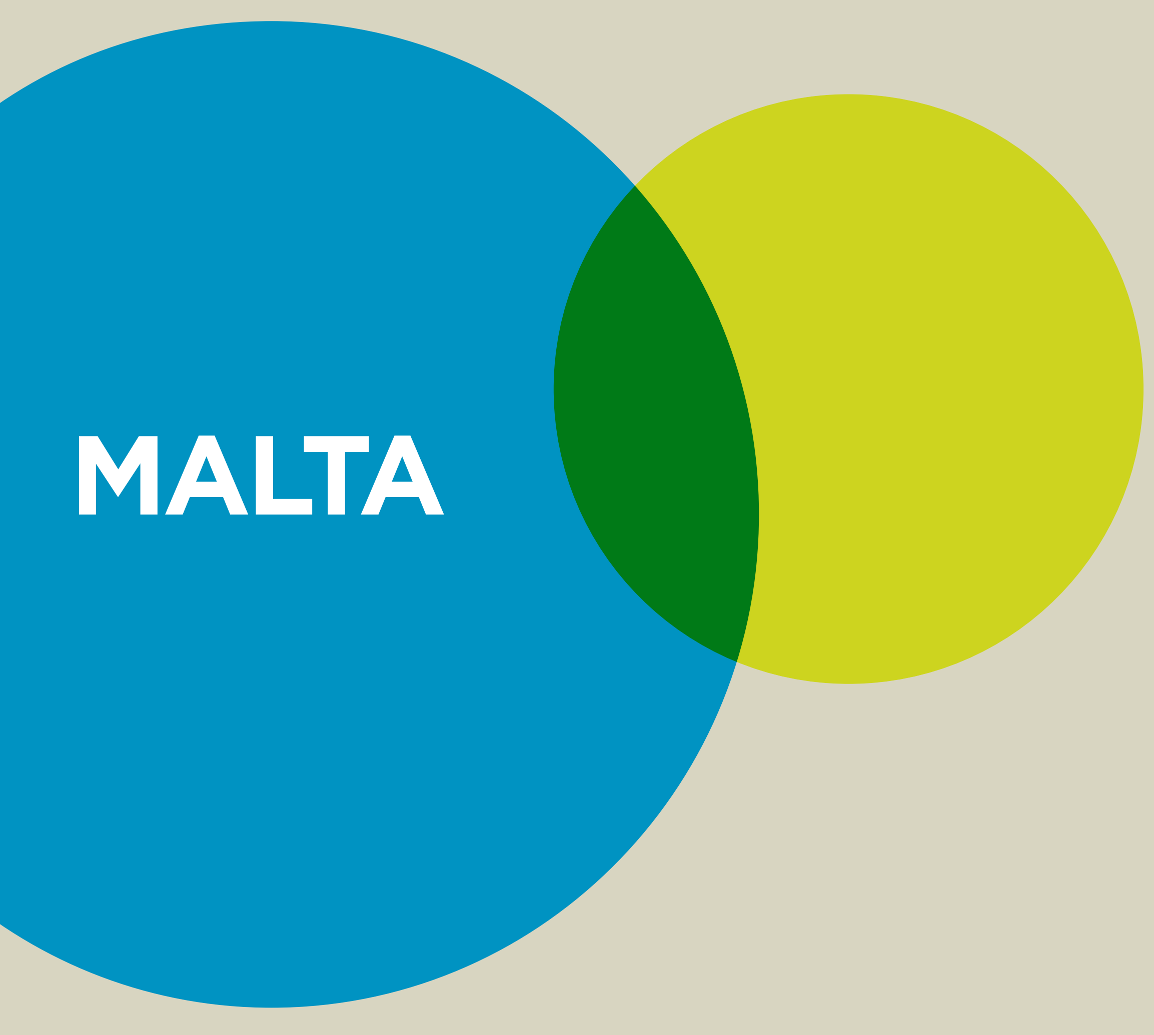

# MALTA

# MALTA

## INTERNATIONAL DEVELOPMENTS

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

Changes to Malta's tax legislation are not frequent and there have been no changes to the income tax legislation which are relevant to the M&A deals and private equity except for the introduction of a Notional Interest Deduction (NID) which is very attractive to companies financed through equity and other contributions since they may claim an allowable deduction to reduce their chargeable income or taxable profits by up to 90%.

Other changes to Malta's tax legislation are often the result of 'Budget Measures' or EU Directives.

### 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?

Malta is not a member of the OECD and, although it endorses some of the BEPS actions, has not amended its tax legislation or renegotiated any of its tax treaties as a direct result of the BEPS action plan. However, since Malta is a Member of the European Union, it has amended the tax legislation to implement the amendments relating to various tax and tax related Directives such as the anti-abuse provisions of the EU Parent Subsidiary Directive, the Country-by-Country Reporting (CbCR), the exchange of information on tax rulings and other tax transparency measures such as the Register of Beneficial Owners (RBO).

As from 2019, Malta will also have to implement the Anti-Tax Avoidance Directive (ATAD) and therefore some of the BEPS Actions will find their way into Malta's tax legislation.

So far Malta has very limited anti-tax avoidance measures and the legislation does not contain any CFC rules or provisions, no exit taxes, no debt to equity ratios or thin cap rules, no withholding taxes and no specific transfer pricing measures. With ATAD I and ATAD II, this may well change.

## GENERAL

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

**A) Share deal**

The purchase of assets through a share acquisition may be subject to duty on documents (referred to as stamp duty). However, exemptions from duty on documents apply if the company has more than 90% of its business interests or activities outside Malta. If the share transfer is not exempt, then duty on documents is computed on the market value of the shares. The market value is usually taken to be the Net Asset Value (NAV) of the shares, adjusted to reflect the market value of any immovable property, any investment in another company and goodwill. Duty on documents is levied at €2 on every €100 of the market value, with the rate being €5 on every €100 if the company has more than 75% of its assets in immovable property situated in Malta.

**Tax advantages:**

It is possible for a group company to transfer losses to another group company if the two companies are considered to belong to the same group for income tax purposes. Common shareholding must exceed 50%, for companies to be considered a group and enable the transfer of trading losses. The surrendering of trading losses must be made within the same tax year. Therefore, any losses brought forward or carried forward cannot be surrendered. Tax losses carried forward by the target company may be utilised by the acquiring company only if

the two companies are merged, unless the Inland Revenue Department considers such merger as being a scheme in which case the anti-abuse provisions apply. Anti-abuse provisions apply when the transfer of losses to a group company arise from profits relating to immovable property situated in Malta.

In certain cross border transactions such as a redomiciliation of a foreign company into a domestic company (transfer of legal seat), a cross-border merger and the change in a company's tax residence by moving the effective management and control, it is possible to have a step-up in the value of assets held by the company. The step-up is not subject to any tax in Malta but may qualify for depreciation or amortization.

**Tax disadvantages:**

The future sale of shares may be subject to capital gains tax at the rate of 35%, but an exemption applies if the transfer is made by a non-resident person and the Maltese company (in which the share transfer is being made) does not have any immovable property in Malta.

**B) Asset deal**

The purchase of individual tangible assets (except for the purchase of immovable property situated in Malta) does not trigger any tax issues. Duty on documents or other taxes are not payable upon the purchase of assets.

**Tax advantages:**

Assets such as industrial buildings (including a hotel and offices) as well as plant and machinery, and used in the production of the income, qualify for a tax deduction in form of capital allowances or wear and tear at prescribed rates using the straight-line method.

Intangible assets such as intellectual property and scientific research may also be depreciated / amortised for income tax purposes over their useful economic life.

**Tax disadvantages:**

Purchase of individual assets may be subject to VAT (at the standard rate of 18%) unless the transfer of assets is a transfer of a going concern, in which case no VAT is applicable.

Goodwill is not deductible or allowable for income tax purposes and it may not be amortised for income tax purposes.

## 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?

Companies that opt to re-domicile to Malta or companies resulting from a cross-border merger are entitled to claim a step-up in the tax base of both tangible and intangible foreign assets without any adverse tax consequences in Malta.

A share acquisition does not entitle the acquiring company to any tax deductions. Therefore, it is not possible to take advantage of an increase in the step-up value of assets during a simple share transfer. However, revaluations are possible and the increase in the value or cost is not subject to any income tax or capital gains tax. A revaluation of local assets does not affect the tax base on which depreciation or amortization may be claimed.

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

Goodwill may not be amortised for income tax purposes. It is a non-deductible expense. Other intangible assets such as intellectual property, trademarks, trade names, research and development may all qualify for amortization over their economic useful life. In some cases, the cost or tax base may be inflated by a percentage, example, 20%.

## 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?

Malta has no debt-to-equity ratios or thin capitalisation rules, and there are no limitations on the deduction of interest provided such interest is incurred in the production of the income. For example, interest paid on a loan used to acquire an investment may be deducted from the dividend income received from such investment (unless the dividend income is exempt under the participation exemption provisions). Although there are no specific rules to limit the deductibility of interest on borrowings, general anti-abuse provisions may limit or disregard amounts, transactions or schemes which reduce the amount of tax payable by any person.

As a rule, no distinction is made between intra-group debt and third-party financing. However, intra-group receivables may be subject to more scrutiny by the tax authorities to ensure that such debt is at arm's length and no interest income is 'lost'.

Interest free borrowings as well as equity and reserves may all qualify for a Notional Interest Deduction (NID) which is currently set at 7.03% and may be claimed as a deduction to arrive at the chargeable income. The NID is limited to 90% of the chargeable income such that the company will pay tax on the 10%. Any unutilised NID may be carried forward and deducted in subsequent years. The amount of NID claimed by the company is brought to charge in the hands of resident shareholders. Non-resident shareholders are not subject to interest income unless they have a PE in Malta or are tax resident in Malta. The NID may also be claimed in conjunction with double taxation relief such as the Flat Rate Foreign Tax Credit (FRFTC).

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

Since Malta has no thin capitalisation rules or debt-to-equity ratios, it is possible to push down debt by an assignment, transfer or contribution. Tax legislation provides that any interest payable on capital employed in acquiring the income is allowable for income tax purposes as long as the interest charged is at arm's length. No duty on documents is payable on the assignment, transfer or contribution of a debt and there are no limitations on debt push-downs.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Given that the interest rates are rather low and the NID on the invested risk capital including interest free loans is set at 7.03%, there is a tax incentive to finance Maltese companies through equity.

## 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 may be transferred from one company to another (within the same group) provided the transfer of the loss is made during the same year in which it arises.

Only trading losses may be surrendered to group companies. Any capital loss as well as unabsorbed capital allowances are carried forward indefinitely and may be deducted against the same type of profits realised in future periods but may not be surrendered to another group company.

Any losses incurred by the target company(ies) before the year of acquisition may not be transferred to other companies after acquisition unless the two companies merge and the merger is not seen by the tax authorities as being tax driven in which case the losses are not allowable.

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

Not really. Malta does not have any specific legislation or rules with respect to thin capitalisation or transfer pricing which may limit certain deductions. However, it is pertinent to point out that Maltese tax legislation contains a general anti-abuse provision as well as some specific anti-abuse provisions that may limit tax deductions or disregard a transaction or a series of transactions.

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

Duty on documents (or stamp duty) is payable by the buyer upon the transfer of shares at the rate of €2 on every €100 or €5 on every €100 of the market value of the shares. The latter only applies in case of companies having immovable property situated in Malta. As already pointed out, exemptions from duty on documents apply if the company whose shares are being transferred has more than 90% of its business interests or activities outside Malta. If no exemption applies, the market value of shares is computed on the basis of the company's NAV, with adjustments for the market value of any other shares held by the company, for increases in the market value of immovable property situated in Malta and for goodwill. Goodwill is calculated as two years' profit based on the performance of the company over the last five years of operation.

Share transfers are not subject to any value added tax.

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

Tax legislation provides that expenses which are incurred in the production of the income are allowable as a deduction. Acquisition costs are normally considered to be of a capital nature and therefore not allowable as a deduction. However, acquisition costs may be subject to capital allowances in the form of wear and tear or amortised over a number of years depending on the nature of the asset acquired and its use.

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

VAT incurred on the acquisition of an asset is usually recoverable for persons having an economic activity in Malta and if such asset relates to the business activity/ies of the company (unless the input VAT is specifically blocked, e.g. on works of art, antiques or motor vehicles).

Holding companies as well as companies engaged in VAT exempt activities may not claim back any VAT incurred upon the acquisition cost but trading companies may claim back any VAT incurred, if the asset purchased (or the capital good as it is referred to in the VAT Act) is used in the economic activity.

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

There are no adverse tax implications for foreign entities acquiring shares in a Maltese company. On the contrary, this may offer tax advantages such as the NID referred to earlier on and the possibility to claim tax credits and tax refunds upon a distribution of profits by the Maltese company to the foreign company. These tax credits and tax refunds may also apply to accumulated profits / retained earnings.

Also, Maltese legislation exempts foreign shareholders from the payment of duty on documents provided the Maltese company has its main interests or business activities outside Malta and the said Maltese company does not own real estate in Malta.

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

Mergers, demergers, amalgamations and reorganisations within a group of companies are tax neutral if the shareholding position of all shareholders remains unchanged.

The above are also exempt from duty on documents and capital gains tax.

No income tax and / or duty on documents are due upon the transfer of immovable property or shares or any other asset between two companies which form part of the same group. Roll-over relief is also available.

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

Exemptions from capital gains tax upon share transfers exclude companies which have immovable property situated in Malta.

Transfer of immovable property is subject to property transfer tax at the rate of 8% applicable on the consideration or market value. Other property transfer tax rates apply in exceptional cases and range between 2% and 10%. Such tax is considered a final tax and no other taxes are applicable (except for the duty on documents payable by the buyer).

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

In the 2016 Budget, the Minister of Finance announced that fiscal unity will be introduced however to date, this budget measure was never introduced.

However, current legislation provides for the transfer of tax losses within a group of companies and the tax deferral upon transfer of assets within a group of companies. Anti-abuse provisions apply in both circumstances.

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

No specific legislation has been introduced for companies holding intangible assets and no special tax status applies. However, companies holding intangible assets, may, depending on the type of intangible asset, amortise the cost over a number of years and claim the amortised part as a deduction against income. In certain cases, such as research and development, the company may inflate the actual cost incurred and the amortization is calculated in the inflated amount.

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

Malta does not impose any exit taxes and there are no adverse tax consequences if the ownership of intangible assets is transferred out of Malta irrespective of whether the transfer is within a group or not.

## 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 realised by a corporate taxpayer are in principle deemed profit and are therefore taxable at the Capital gains are brought to charge together with any other income. Capital gains apply upon the transfer of shares (unless the participation exemption applies) and the transfer of immovable property. Capital gains may also apply on some other specific types of assets such as patents, trademarks and trade names.

The applicable income tax rate depends on whether the gain is realised by an individual or a company. Individuals are taxed at progressive rates, with the highest tax rate being 35% (unless individual has a special tax status under a specific programme). Companies are taxed at a standard rate of 35% subject to double taxation relief. Also, a Maltese company in receipt of foreign source capital gains (which do not qualify for the participation exemption) may claim a Flat Rate Foreign Tax Credit (FRFTC) of 25% so that the tax payable is reduced from 35% to 18.75%. Upon a distribution of such gains or profits, the shareholder may be entitled to claim a tax refund equivalent to two thirds of the tax paid by the company so that the combined overall Malta effective tax (COMET) is 6.25%. The COMET of 6.25% may be reduced even further if the company also claims the NID.

Transfers made by a non-resident person in a Maltese company are exempt from tax as long as such company does not hold immovable property situated in Malta.

Malta's participation exemption is quite 'generous' and applies to dividend income as well as to capital gains arising from the transfer of a participating holding.

If the equity investment made by a Maltese company qualifies as a participating holding, then any capital gains realised upon the disposal or transfer of such investment is exempt from any tax. An investment qualifies as a participating holding if any one of the following conditions is satisfied:

- The Maltese company has at least 10% of the equity shares in another company; or
- The Maltese company is an equity shareholder in a company and is entitled to purchase the balance of the equity shares of the company, or it has the right of first refusal to purchase such shares; or
- The Maltese company is an equity shareholder in a company and is entitled to either sit on the board or appoint a person on the board of that subsidiary as a director; or
- The Maltese company is an equity shareholder which invests a minimum of €1,164,000 (or the equivalent in a foreign currency), and such investment is held for a minimum uninterrupted period of 183 days; or
- The Maltese company holds the shares in a company to further its own business, and the holding is not held as trading stock for the purpose of a trade

The participation exemption is also extended to dividend income received from a participating holding if the body of persons in which the participating holding is held, satisfies any one of the following three conditions:

- It is resident or incorporated in the EU; or
- It is subject to foreign tax of a minimum of 15%; or
- It does not derive more than 50% of its income from passive interest and royalties

Alternatively, the equity investment must satisfy the following two conditions:

- The shares in the non-resident company must not be held as a portfolio investment
- The non-resident company or its passive interest or royalties have been subject to tax at a rate not less than 5%

If the dividend income does not qualify for the participation exemption, the Maltese company in receipt of dividend may avail itself of any double taxation relief or unilateral relief. If no proof of foreign tax suffered is available but the company has proof that the dividend income is foreign source, it may avail itself of the FRFTC. The NID may also apply.

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

Rollover relief is available to companies that transfer an asset used in the business for a period of at least three years and replaced within one year. As a result, any profit realised upon the sale of the asset, including immovable property, will not be brought to charge, but the original cost of the asset or the immovable property, is reduced by the realised gain subject to the rollover relief. Therefore, such relief defers the tax liability until the asset is disposed of and not replaced.

Anti-abuse provisions may apply to minimise tax avoidance when an asset is replaced by another asset of a lower value than the original one.

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

Malta does not have any specific legislative requirements with respect to local substance since the basis of taxation for companies incorporated in Malta is on a world-wide basis, and therefore subject to tax on all its income, irrespective to where such income is generated or remitted.

However, local substance is important and indeed necessary when determining the tax residence of companies incorporated outside Malta. Indeed, a foreign company is considered to be tax resident in Malta only if the company is effectively managed and controlled in /from Malta. The tax authorities normally look at the composition of the board of directors, where meetings are held and that the decisions are effectively taken whilst in Malta.

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

Mergers are generally considered to be tax neutral and therefore there are no tax advantages (or disadvantages) in mergers. No VAT or duty on documents is imposed on the merger of two entities and thus no taxation is due.

# MANAGEMENT INCENTIVES

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

Any remuneration to employees, including management, is subject to tax irrespective of the form of payment granted. Any non-cash remuneration is treated as a fringe benefit in Malta and subject to tax in Malta. This applies to individuals whose income is subject to tax in Malta by virtue of their residence and/or domicile.

The exercise of a share option is treated as a fringe benefit under Maltese legislation and taxed at a flat rate of 15%. The taxable event is triggered when the employee exercises the option and acquires shares in the company or whenever an employee receives shares under a share award scheme. The value of the benefit is the excess, if any, of the market value of the shares at the time when the shares are transferred over the price paid for those

shares by the employee. Taxation is charged at the flat rate of 15% on the value of the benefit. The fringe benefit is treated as income that is separate and distinct from the employee's other income. The benefit is treated as income derived at the time when the employee acquires the shares and as arising in the country where the employer is performing his duties at that time.

The employee may subsequently transfer the shares at a profit. For the purpose of determining the taxable profit upon the disposal of shares, the cost of the shares is not the price actually paid by the employee but the market value (if higher) established for the purpose of determining the fringe benefit.

Tax incentives may apply for highly qualified persons. The objective of the Highly Qualified Persons Rules is the creation of a scheme to attract highly qualified persons to occupy "eligible office" with companies licensed and/or recognized by the Malta Financial Services Authority (MFSA), companies licensed by the Malta Gaming Authority (MGA) and undertakings holding an Air Operators' Certificate or an Aerodrome Licence issued by the Authority for Transport in Malta.

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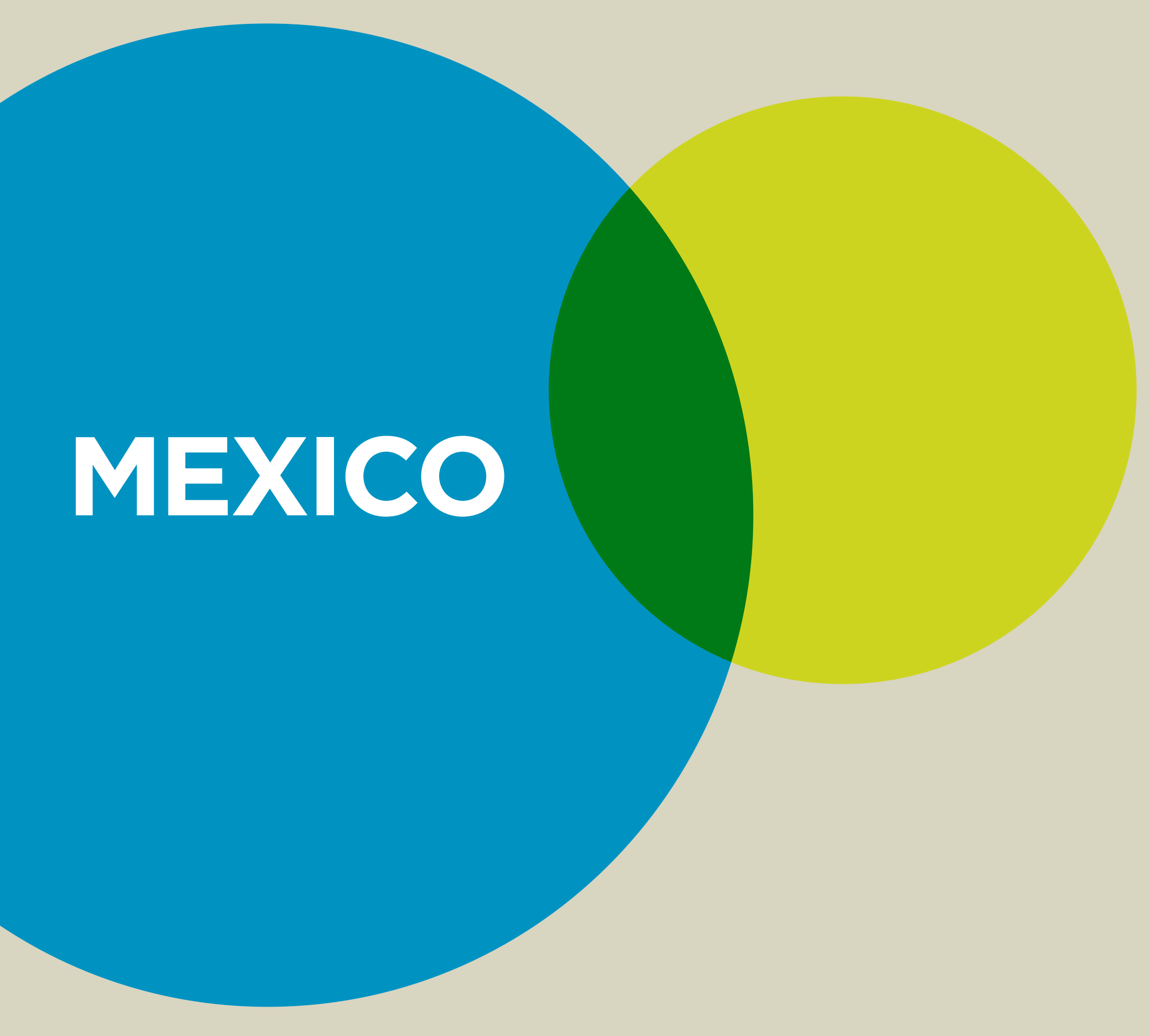
MEXICO

# MEXICO

## INTERNATIONAL DEVELOPMENTS

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

Recently, anti-abuse rules regarding the transfer of tax losses in the context of business restructures have come into force. The approved legislation establishes that where tax losses have been generated pursuant to certain regulated scenarios, and the tax loss generating entity is part or a business restructuring or change of shareholders in such a way that the entity entitled to offset said losses ceases to be part of the original group, then the right to offset such losses may be challenged by the tax authorities absent proof of non-tax related motives. Furthermore, the unlawful transfer or tax losses will be deemed as such when the party that generated the tax losses no longer forms part of the original group after any form of restructuring that causes said entity to exit the group.

Pursuant to Article 25, section I, of the Federal Revenue Law, taxpayers are obligated to disclose certain relevant transaction information and restructurings entered into by the group. This relevant transactions' disclosure return obligates taxpayers to inform the tax authorities on a quarterly basis about related party transactions that exceed the threshold of MXN 60M (approximately US 3.2M) in five appendixes: i) financial derivative transactions, ii) related party transactions, iii) changes in shareholders and tax residence, iv) reorganizations and restructuring within the multinational group and v) other relevant transactions. The information requested in each appendix is aimed to identify harmful tax practices such as abusive financial derivative transactions entered into between related parties, relevant transfer pricing adjustments that may erode the Mexican tax base, direct and indirect changes of shareholding and dual residence, changes in the business model that may imply functions, assets and risks being shifted between jurisdictions, centralization or decentralization of functions, and other practices where the tax authorities may see a risk of tax avoidance such as debt financed dividends or transfer of losses after mergers or spin-offs.

On other fronts, taxpayers entering into outsourcing of payroll within a group must request to the outsourcing proof of tax compliance with its employee related tax obligations in order to make such payments deductible, and VAT creditable.

### 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?

The tax reform introduced in Mexico effective as from 1 January 2014 along with administrative regulations, has led to a comprehensive early adoption of BEPS actions within the Mexican tax regime.

As from 2014, a hybrid mismatch rule was introduced establishing that the deduction of any payments made by Mexican tax residents would be disallowed if the deduction is also picked up at the level of a national or a foreign resident related party (unless such related party considered such payment in its taxable basis). Furthermore, the deduction of interest, royalty and technical service fee payments made to controlling or controlled fiscally transparent entities by Mexican resident corporations would be disallowed unless such payments are taxable at the level of their shareholders or partners, and such payments are at arm's length.

Prior to BEPS, Mexico introduced Controlled Foreign Corporation (CFC) rules applicable to preferential tax regimes where income is obtained through a subsidiary in a low tax jurisdiction or through a transparent entity. Accordingly, Mexican resident entities that carry out activities through preferential tax regimes and transparent entities are taxed on income obtained through a CFC even if there have not been any distributions and they are required to file a disclosure return annually. Recently, the obligation to file such informative return has been extended to taxpayers holding investments in transparent entities or through entities in black listed jurisdictions.

Furthermore, a disclosure return of relevant transactions has been put into place, where it is aimed to identify certain tax planning structures within related parties. Additionally, as a Multilateral Competent Authority Agreement signatory, Mexico has implemented country-by-Country reporting obligations for information pertaining to fiscal year 2016 onwards.

As from 2014, legal requirements to obtain treaty benefits by Mexican residents have been strengthened, prior to BEPS Action 6 (Treaty Abuse). In addition to the requirement that Mexican residents must obtain a certificate of residence of the foreign resident to apply treaty benefits, the Mexican tax authorities may request foreign resident taxpayers to prove the existence of juridical double taxation being relieved under the applicable tax treaty, as well as an explanation of the tax treatment given in the country of residence.

In recent tax treaty negotiations, Mexico has included Principal Purpose Test (PPT) or Limitation of Benefits (LOB) clauses to restrict treaty benefits in abusive situations.

Regarding BEPS Action 15 (Multilateral Instrument), as a historically early adopter of OECD measures and as a member of the ad hoc Group that participated in the negotiations, Mexico has signed the multilateral instrument, which is still pending approval from Congress to become effective. The MLI will be applicable to 61 Covered Tax Agreements (CTA). Mexico's already has in its CTA several provisions in line with the MLI, for which reservations have been issued in connection with transparent entities and dual residence issues, which will need to be analyzed case by case. Furthermore, Mexico has opted for the simplified LOB provision.

Regarding Mexico's PE position, it has notified that its CTA already address the determination of a dependent agent PE's subject to the habitual exercise of an authority to conclude contracts in the name of the enterprise and that an enterprise shall not be deemed to have a PE in a Contracting Jurisdiction in respect of activities undertaken for said enterprise by an agent of an independent status. Furthermore, Mexico has opted to amend the PE provisions contained in the CTA to deal with the artificial avoidance of PE status through specific activity exemptions, but has reserved the right for the provision in connection with splitting up of contracts not to apply to its CTA.

With respect to the arbitration mechanisms contained in the MLI, Mexico has not chosen its application.

## GENERAL

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

**A) Share deal**

**Tax advantages:**

- Acquisitions of shares of a corporation or partnership interest of a limited liability company are not subject to value added tax (VAT) or stamp tax in Mexico
- No transfer taxes are triggered during a share acquisition (e.g. real estate transfer tax)
- The acquisition price will form part of the tax cost basis of shares of the buyer for subsequent sales
- Tax attributes remain with the acquired entity although limitations may apply for the application of tax losses

**Tax disadvantages:**

- A loss obtained by a non-resident seller on the sale of an entity may not be offset against future capital gains for Mexican tax purposes
- The target company's liabilities and possible tax contingencies remain in the target company. The statute of limitations in Mexico is of five years

- The buyer is generally not allowed to deduct the financing costs of the acquisition against the target's future profits
- If the buyer is a foreign resident and acquires shares at a value that is at least 10% lower than the appraisal value of the shares, the tax authorities may assess a deemed income to the foreign buyer on the difference between the actual sales price and the appraisal value of the shares. The foreign buyers then must pay a 35% income tax on the difference between the sales price and the appraisal value.

**B) Asset deal**

**Tax advantages**:

- Step-up of the value of the assets for the purchaser
- The cost of assets purchased may be deducted via depreciation either on the fiscal year that they are put to use or in the following year
- Seller may be able to offset accumulated tax losses against capital gains derived from the disposition of assets
- VAT is applicable in a purchase of assets at a general 16% rate. If the buyer were a foreign resident, the VAT would be a final tax payment with no possibility to recover. If the buyer were a Mexican company, VAT paid would generally be creditable against VAT due, and therefore, recoverable
- The target company's liabilities and possible tax contingencies are not transferred to the buyer unless the transfer is deemed the acquisition of an ongoing concern.

**Tax disadvantages:**

- Tax attributes such as accumulated tax losses of the target are not transferred to the buyer
- Real estate transfer tax is applicable on the transfer of real estate property situated in Mexican territory. This tax is levied at the local level at a rate that may go from 2% to 5% of the value of the property
- Regardless of the general rule that the target company's liabilities are not transferred to the buyer, Mexican tax provisions establish that, in case of the acquisition of an ongoing concern, the buyer will be jointly and severally liable with the seller for any taxes triggered from the activities carried out by such business.

## 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?

Mexican tax law does not contain provisions to allow step up in the value of assets in share deals. For this reason, while assessing a business acquisition, it will be relevant to determine at which level the tax cost basis is required.

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

Mexican Income Tax Law (ITL) does not allow for the deduction of goodwill. Goodwill paid as part of the purchase price of shares of a company is part of the tax basis of the shares, which can be deducted from the sales price in a subsequent sale (provided however that the overall original acquisition price was at market value at the time of purchase).

## 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?

For income tax purposes, interest is deductible when:

- The capital is invested for the attainment of the purpose of the business
- If the taxpayer grants loans to third parties, employees or shareholders, only the interest accrued on borrowed capital for up to the amount of the lowest interest rate set forth in the loans to third parties to the taxpayer's employees or to its shareholders on the portion of the loan made to the latter parties will be deductible. These limitations do not apply to banking institutions, regulated multiple purpose financing companies or ancillary credit organisations regarding transactions that are inherent to their activities
- Interest must be determined at a fair market value. Any excess will be considered non-deductible

Thin capitalization rules disallow the deductions of interest on debt owing to foreign related parties if the total amount of interest bearing debt exceeds a three to one debt equity ratio. Likewise, interest may be re-characterized as a dividend if the loan is considered a back-to-back loan, and non-deductible as such. Although it has been evaluated by the Mexican tax authorities, it is not foreseen whether in the near future the best practice contained in BEPS Action 4 will be implemented to limit interest deductibility based on a net interest/EBITDA ratio.

Although interest expense on a debt subscribed for dividend distribution purposes is not generally prohibited, Mexican tax authorities have the position that interest derived from a loan obtained to pay dividends to shareholders is non-deductible because they consider that such loan is not used for the business purpose of the company. In a similar fashion, the Mexican tax authorities are not fond of debt-pushdowns even if there is no particular provision that prohibits them.

As of fiscal year 2014, anti-abuse provisions to tackle hybrid mismatches and other abusive positions have been introduced in Mexico's ITL. Any interest or royalty payments made to foreign resident controlled or controlling fiscally transparent entities is non-deductible unless the corresponding income is picked up and taxed at the level of the shareholders or partners. This rule aims to deny the deductibility for Mexican tax purposes of interest, royalty and technical assistance payments which are not subject to tax in another jurisdiction, either in the jurisdiction of the entity receiving the payment or of its shareholders.

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

The usual strategy to push-down debt on an acquisition is to incorporate a Mexican acquisition company to borrow the purchase funds. Following the purchase, the acquisition company is merged into the target company so it pays debt and interest from operating cash flows. The merger may qualify as a tax neutral transfer of assets subject to the fulfilment of certain requirements. Nevertheless the Mexican tax authorities may challenge the deduction of the interest considering that such interest is not strictly necessary for the purposes of the surviving company.

Tax consolidation was used to optimize a group's tax burden utilizing the deduction of acquisition debt interest (with the associated recapture of losses if the holding company did not individually generate sufficient profits to amortize the loss derived from financing). However, as from fiscal year 2014, the tax consolidation regime was substituted by a fiscal unity regime which only allows the deferral of taxes for a three-year period.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Under Mexican ITL there is no deemed interest deduction for equity contributions or deductibility of paid in capital. However, capital reimbursements that do not exceed the paid in capital, subject to certain computations set forth in the ITL, are considered tax free distributions. There are however anti-abuse provisions set forth to avoid the result of a transfer of shares through capital increases and future capital redemptions by another shareholder.

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

The target company may carry forward the net operating losses for a period of 10 years after they were incurred. The target company may offset such tax losses against the profits corresponding to the same business lines as those in which the losses were incurred if the purchaser acquired more than 50% of the shares of the target. Mexico does not allow carryback of losses.

Tax losses cannot be transferred in the case of a merger. Similarly, as in the case of change of control of an entity, the tax losses incurred by the surviving entity may only be offset against profits derived from the same business activities that generated such losses. In the case of spin-offs, tax losses are divided between the spun-off entities in the same ratio in which inventory and receivables are assigned in the case of trading companies, and in the same ratio as fixed assets in the case of other companies. If the taxpayer changes its business activity, this will not result in forfeiting the possibility to offset tax losses generated in the conduction of a different business line against profits obtained from the new business since the restriction shall only apply to the abovementioned cases.

Furthermore, certain rules to disallow the transfer of tax losses that permit the Mexican tax authorities to disregard the offset of such losses in case of abusive situations have been recently enacted. Generally, where the entity that generated tax losses is part of a corporate restructure or change in shareholders, and as a result the entity that may offset such tax losses leaves the group, the Mexican tax authorities may presume it is an abusive situation and may challenge the transaction absent proof of non-tax related motives.

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

The statute of limitations in Mexico is of 5 years, with the possibility to be extended to 10 years in cases where the taxpayer is not registered, does not comply with book-keeping obligations or fails to file tax returns being obligated to do so. When performing a due diligence it is important to review the tax attributes such as the Contributed Capital Account (CUCA), the Net After Tax Profits Account (CUFIN), the Net After Tax Reinvested Profits Account (CUFINRE) and the expiration of tax losses.

The CUCA is an account kept for tax purposes whereby paid in capital is registered for future tax free distributions. The CUFIN account is formed from profits that have been taxed at a corporate level. Dividends distributed up to the amount of the CUFIN are free from corporate taxation. Dividends distributed from CUFIN balances generated prior to 31 December 2013 are not subject to the additional 10% withholding tax levied on dividends distributed to foreign residents and Mexican individuals. The CUFINRE is a balance conformed by reinvested untaxed profits for the deferral of taxation, which tax is triggered upon distribution of such reinvested profits.

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

Mexico has no indirect taxes (VAT, stamp duty, transfer tax, etc.) on transfer of shares.

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

The acquisition costs of shares can only be offset against the profits derived from a following sale of such shares. The tax basis is adjusted subject to a particular procedure set forth in the ITL to reach the adjusted cost basis, which takes into account tax losses incurred by the company and retained profits during the shareholding period, capital reimbursements and previous losses offset against profits obtained during the shareholding period.

The acquisition cost of assets used in the taxpayer's business activities can be deducted by means of depreciation subject to the maximum yearly rates set forth in the ITL, depending on the type of business asset or the sector in which it is used. In some cases, the amount that can be deducted in the acquisition of an asset is

limited. The ITL also provides for immediate depreciation (full deduction of the acquisition cost in the first year) in particular industries (e.g. generation of renewable energy) or for small to medium taxpayers.

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

VAT is triggered in the case of the purchase of business assets but not in the case of the purchase of shares. VAT paid in the purchase of business assets can be offset against VAT triggered during the business activities of the taxpayer insofar as certain requirements are fulfilled. Additional requirements have been established for the recovery of VAT incurred during a pre-operative period as from 2017. Any VAT that is paid and that cannot be offset against to VAT triggered (given certain limitations for offsetting contained in the VAT law) is deductible for income tax purposes.

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

Foreign residents who acquire the interest of Mexican target companies for a sales price that deviates in more than 10% from the appraisal value determined by the Mexican tax authorities are subject to income tax at a rate of 35% with no deduction on the difference between the appraisal value and the sales price effectively paid. Such difference will increase the tax basis of the purchaser for purposes of a subsequent sale. Furthermore, in case of a transfer of share where by no consideration is established, the tax will be determined at a 25% rate with no deduction on the appraisal value performed by an authorized party.

In general, Mexican resident target companies are jointly liable for the taxes due by the former shareholders in a share deal if the target company proceeds with the registration of the acquiring shareholder in its shareholder registry and does not receive from the acquiring shareholder proof of compliance with its income tax withholding obligations or proof of tax compliance of the seller's obligations derived from the sale. Thus, it is important to ensure that when a foreign company is the purchaser, the seller duly complies with its income tax payment obligations. Furthermore, the tax unity regime is allowed only for companies which are resident in Mexico for tax purposes. As a consequence there is no possibility to consolidate a foreign company with a Mexican company for tax purposes. Furthermore, tax free reorganizations are not allowed between foreign entities and Mexican entities, for example, the merger of a Mexican entity with a foreign resident entity cannot apply for a tax-free transfer of assets.

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

Mexican law provides for a tax neutral regime applicable to some qualifying corporate restructurings, such as mergers, spin-offs, contributions-in-kind and exchanges of shares.

Subject to certain requirements, companies can achieve tax-free mergers and spin-offs whereby any transfer of assets is not considered as such for income tax and VAT purposes. In the case of mergers and spin-offs resulting from a corporate restructure, the requirements set forth in the ITL described in the following paragraph must be additionally met. Tax free mergers and spin-offs can only be achieved where the entities entering into the merger, or resulting from the spin-off are Mexican resident for tax purposes.

In the case of corporate restructures concerning Mexican resident legal entities, the Mexican tax authorities may authorize a transfer of shares at cost basis within entities forming the same corporate group. Subject to other requirements, the shares received and the shares transferred by each entity must remain directly held by the acquirer and within the group for a period of at least two years following the date of authorization of the restructure, and the shares received by the taxpayer must represent the same percentage that such shares represent in the paid in capital of the entity whose shares are received, as the percentage that the shares being transferred in turn would represent, prior to the transfer, in the consolidated capital of both entities.

Regarding the contributions-in-kind and exchange of shares, the Mexican tax authorities have to authorize the corporate restructuring before it is executed and the benefit of the authorization is a deferral in the payment of the tax that would have been triggered without the reorganization authorization. The transfer value to be considered for purposes of the deferral is the tax basis of the shares. In any case, several formalities and requirements must be fulfilled to qualify for the tax neutral regime. Among others, the related parties must not be resident in a preferential tax regime.

Mexico also has some tax treaties in place which allow for tax free or tax deferral reorganizations (e.g., United States, the Netherlands, Luxembourg, Hong Kong and Spain, among others).

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

Income derived from the transfer of shares or securities that represent the ownership of assets will be considered Mexican-source income when the entity who issues the shares or securities is a Mexican resident or when more than 50% of the book value of said shares or securities derives, directly or indirectly, from real estate property located in Mexico.

In this sense, if a foreign resident indirectly sells the shares of a Mexican company whose value is represented substantially by Mexican real estate, such a transaction would be taxable in Mexico. Tax treaties entered into by Mexico may contain an indirect ownership rule in order for Mexico to be able to consider that the sale is Mexican sourced and therefore taxed in Mexico.

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

Tax integration (consolidation) is available under Mexican ITL, which allows for the deferral of income tax for a period of three years. The application of the integration regime requires the holding and the subsidiaries to be Mexican residents and the holding company must have above 80% ownership in all integrated subsidiaries, directly or indirectly. Furthermore, the holding company must be owned in more than 80% by Mexican resident shareholders or foreign resident shareholders resident in a country who has entered into a broad exchange of information agreement with Mexico.

Each entity of the integrated group would determine an individual taxable income or operating losses, as the case may be, and in the annual return the losses belonging to group members may be offset pursuant to a specific mechanic. The difference between the integrated taxable income and the taxable income that would have been realized had there been no integration will be deferred for three years and covered updated by inflation.

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

There is no special tax status applicable in Mexico such as a patent box or intangible holding company regime.

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

There are no specific limitations pertaining to the transfer of ownership of intangibles out of Mexico, however, this type of transaction must be reported as part of the taxpayers' obligation to disclose certain relevant transaction information and restructures entered into by the group. Derived from the foregoing, the Mexican tax authorities may identify and challenge the transaction from a transfer pricing perspective or deny the deductibility of royalty payments abroad where it is not demonstrated that the foreign resident has the technical capacity to provide the services related. In this respect, the Mexican tax authorities have issued a non-binding criterion by means of which

certain situations where the transfer of intangibles originated in Mexico to foreign related parties, or the payment of royalties thereof, are regarded as a harmful tax practice where the transaction does not have a valid business reason or is not set at arm's length.

## 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?

Mexican tax provisions provide that income obtained by a foreign resident derived from the sale of shares will be considered Mexican source income if:

- The issuer of the shares is a Mexican entity
- The value of shares is represented directly or indirectly by more than 50% of real estate property located in Mexico

The ITL provides the following options to compute income tax arising from the sale of shares:

- 25% on the gross amount of the transaction (sales price) with no deductions allowed
- 35% on the gains (sales price deducted by the tax cost basis) provided that several formalities are fulfilled, such as the appointment of a legal representative in Mexico for purposes of the sale and the filing before the Mexican tax authorities of a tax report of the transaction issued by a registered public accountant

Taxation on the capital gain pursuant to the foregoing is only allowed to the extent that the foreign resident is not subject to a preferential tax regime or to a territorial tax system. A 40% withholding rate may apply to sales of shares made by residents of a preferential tax regime in related party transactions.

Capital gains derived from the sale of shares of listed Mexican companies in a recognized stock exchange and shares issued by variable yield investment funds are subject to a 10% tax rate on the gains.

There is no participation exemption regime or a similar concept under Mexican tax law, however, as mentioned earlier, Mexican ITL allows for a deferral regime for qualifying corporate restructurings. Further, the tax rate on capital gains may be reduced or even eliminated by means of a tax treaty.

For Mexican resident companies, capital gains are taxed as ordinary income with no special capital gains treatment. Hence, such capital gains would be subject to the 30% corporate income tax rate. A loss in the sale of shares may be offset against future capital gains subject to the fulfillment of certain requirements.

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

There is no particular advantage or deferral benefit for reinvesting proceeds from the sale of shares or assets.

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

There are no local substance requirements for foreign holding companies, nor any further rules are envisaged after BEPS.

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

Any transfer of assets derived from a merger or a spin–off is in principle considered as a sale of such assets and triggers income tax, VAT, and in the case of real estate, is subject to real estate transfer tax. However, in the case of the transfer of assets derived from a merger or a spin-off involving Mexican resident entities, the transfer can be disregarded as a sale for income tax and VAT purposes (not for real estate transfer tax), thus not triggering these taxes. To qualify for this treatment, the following requirements must be met:

- Tax free merger: Filing of a merger notice before the Mexican tax authorities (and of the merged entity's final annual tax return by the merging entity) and after the merger, the surviving entity continues to carry out the activities that it and the merged company had conducted before the merger, for a minimum period of one year immediately following the date on which the merger becomes effective. This last requirement will not be applicable if the following requirements are met: (i) The income from the principal activity of the merged company for the fiscal year immediately preceding the merger derived from the leasing of assets used in the same activity as that carried out by the merging company; and (ii) In the fiscal year immediately preceding the merger, the merged company has received more than 50% of its income from the surviving company, or the latter has received more than 50% of its income from the merged company
- Tax free spin-off: The shareholders owning at least 51% of the voting shares of the spun off entities are the same for a period of one year before and two years after the spin-off takes place, and must maintain the same level of participation in both resulting entities for such period. When an entity ceases to exist following a spin-off, such entity must designate a legal representative to comply with its outstanding tax obligations, such as the filing of the pending annual tax return

Further, to achieve a tax-free merger within five years following a previous merger or spin-off, authorization from the Mexican tax authorities is required prior to carrying out the merger.

Real estate transfer tax is levied at State level and is triggered at a rate that may vary from 2% to 5% on the cadastral value, sales price or appraisal value (whichever is higher), depending on the State in which such real property is situated. This tax is generally collected by the notary public.

Finally, there are rules in place that allow the deferral of taxation derived from the transfer of shares in the restructuring of certain investment vehicles that hold immovable property and energy related assets, subject to the fulfillment of certain requirements.

# MANAGEMENT INCENTIVES

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

Income earned by individuals from the exercise of stock options granted by the employer or a related party thereof are treated as employment income for Mexican tax purposes. The option will be taxed upon exercise on the difference between the market price of the stock at the moment of exercise and the value set at the moment of vesting of said stock. Furthermore, the price considered for the determination of the aforementioned taxable income will be the tax basis of the employee in a subsequent sale of the stock. In case of Mexican resident individuals, the stock option income will be subject to a progressive rate with a maximum tax rate of 35%.

Where foreign resident individuals perform management services, such services will be sourced in Mexico when they are performed within Mexican territory. In this regard, stock options income sourced in Mexico and earned by a foreign resident will be subject to (i) exemption for the first MXN 125,900 (approximately US 6,700), (ii) a 15% rate with no deductions between MXN 1M (approximately US 53,000) and the previously mentioned threshold, and (iii) a 30% rate with no deduction thereafter.

Payments made by foreign residents without a permanent establishment in Mexico or with a permanent establishment to which such services are not connected will be exempt from taxation in Mexico if the services rendered do not exceed 183 days in any 12-month period. Conversely, where the payments are made by a Mexican resident or a foreign resident with an establishment in Mexico (not necessarily a permanent establishment) to which such services are connected, or where there are complimentary payments made by a foreign resident to payments made by Mexican residents or permanent establishments in Mexico to which such services are connected, such services will be taxable in Mexico.

There are no special tax considerations in Mexico for management incentives, such as sweet equity or manager remunerations.

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# THE NETHERLANDS

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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?

There are various relevant developments for M&A deals and private equity in the Netherlands. In line with the implementation of the actions under the BEPS Action Plan, the Netherlands signed the Multilateral Instrument (MLI) in 2017 (some observations were made, please refer to question 2).

The EU Anti-Tax Avoidance Directive I (including earning stripping, CFC-rules, exit taxes, GAAR and EU hybrid mismatches) and the EU Anti-Tax Avoidance Directive II (third country hybrid mismatches) are expected to be implemented as per 2019 and 2020 respectively. It is yet unknown when the legislative proposal will be published for public comments. From a Dutch tax perspective the most relevant provisions included in both directives are the reverse hybrid mismatch rule, as this impacts current CV/BV situations, and the earnings stripping rule.

Moreover, the Dutch Government amended the Dutch dividend withholding tax regime as per January 2018 to equalize the Dutch dividend withholding tax treatment of cooperatives and NV / BV's. The changes broadened the scope of the Dutch dividend withholding tax exemption and are therefore a welcome improvement of the Dutch investment climate. NVs and BVs are now treated similarly as cooperatives and are in principal not subject to Dutch dividend withholding tax unless anti-abuse rules apply. Furthermore, non-operational cooperatives are now in principle subject to Dutch dividend withholding tax. Additionally, the scope of the dividend withholding exemption in Dutch tax legislation is expanded to shareholders/members of NV/BVs and cooperatives situated in treaty countries. As a result, the investment structures of mainly non-Dutch private equity investments need to be reviewed in order to determine what the impact of the changes will be. Mainly private equity investment structures with the use of entities in non-treaty jurisdictions, intermediary holding companies with insufficient substance and Dutch holding cooperatives will be impacted.

The Dutch Government has also proposed some additional amendments in the near future: 1) the potential abolishment of the dividend withholding tax as per 1 January 2020; 2) the potential implementation of a conditional withholding tax on dividends (1 January 2020), interest (2021) and royalties (2021); 3) further restrictions may be implemented to the fiscal unity regime (please refer to question 17).

### 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?

As other OECD Member States, the Netherlands has committed to the OECD minimum standard concerning treaty abuse. The Dutch State Secretary has announced that the proposed anti-abuse rules will be part of treaty negotiations and no reservations were made with regard to the anti-abuse rules in the MLI. There are furthermore on-going efforts to renegotiate tax treaties with developing countries in order to include an anti-abuse rule.

The MLI is signed, but not ratified, by the Dutch Government in June 2017. After ratification by the Netherlands, the earliest moment for the entry into force of the MLI for the Netherlands is 1 January 2019 for the withholding taxes and 1 January 2020 for all other taxes due to the required transition period of the MLI. Furthermore, both treaty partners in a bilateral treaty have to ratify the MLI and have to get through the transition period before the MLI will apply on that particular treaty.

Following the EU Anti-Tax Avoidance Directive I the Netherlands is currently working on implementing the rules as set by the Directive in national law (i.e. a CFC and an earning stripping provision will be included). Please refer to question 6 for more information on the implementation of the earning stripping rule. As indicated in paragraph 1 the EU Anti-Tax Avoidance Directive II is expected to be implemented as per 2020. It is expected that a legislative proposal will be published for public comments early 2018.

## GENERAL

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

**A) Share deal**

**Tax advantages:**

- The buyer may benefit from the target company's carry forward losses
- Better structuring possibilities are available to mitigate Dutch real estate transfer tax being due if the target company owns real estate
- The seller may be able to apply the participation exemption, which exempts income (capital gains and dividends) derived from qualifying shareholdings

**Tax disadvantages:**

- Shares can in principle not be depreciated as opposed to business assets and no amortisation of goodwill
- The buyer is in principle liable for the target company's existing (tax) liabilities
- The buyer may incur a potential dividend withholding tax liability on retained earnings
- In principle, costs relating to acquisitions as well as disposals of participations qualifying for the participation exemption are not tax deductible at the level of the acquiring (Dutch) company
- An interest deduction limitation may apply at the level of the acquiring (Dutch) company

**B) Asset deal**

**Tax advantages:**

- The acquired assets and goodwill can be depreciated/amortised for tax purposes at the purchase price (fair market value).
- In general, no (tax) liabilities are inherited
- No limitation of interest deduction should apply at the level of the acquiring (Dutch) company and no need for debt push down structuring
- The Dutch loss-making companies of the acquirer's group (if any) can absorb profitable operations of the target company
- In principle all acquisition costs are tax deductible

**Tax disadvantages:**

- Capital gains taxation arises at the level of the seller (which should be reflected in the purchase price)
- Possible 2%-6% Dutch real estate transfer tax is levied if the assets consist of Dutch real estate
- The potential benefit of the target company's carry forward losses is retained by the seller (if still available after the sale of the assets)

## 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?

Due to the application of the Dutch participation exemption there are very limited planning strategies to create a step up in share deals. There are however possibilities to create a step up (by means of a voluntary revaluation of assets) in case losses forfeit due to a change of ownership under the anti-abuse rules. Furthermore, in specific situations a step up may be claimed in case a target company exits a Dutch fiscal unity upon the acquisition.

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

Goodwill reported for financial purposes following a purchase price allocation of the shares acquired is ignored for tax purposes (goodwill is included in the cost price of the shares). Acquired goodwill (in an asset deal) can in general be depreciated in at least 10 years (at an annual rate of 10%). Self-developed goodwill can generally not be capitalized and can therefore not be amortized. Other (intangible) assets can be amortized in at least 5 years (at an annual rate of 5%).

### 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?

**General**

The Dutch Corporate Income Tax Act provides for numerous and complicated interest deduction limitations. Therefore professional tax advice should be sought in this regard. The summary of the interest limitation rules as described below should be taken into account with regard to financing of the acquisition of shares or assets (assuming that the financing is already qualified as at arm's length debt financing under Dutch tax law and case law).

**Acquisition of shares**

- Under the general anti-base erosion provision, interest deduction is denied in respect of intra-group loans relating to certain tainted transactions, among which the acquisition of a subsidiary (related party to be), a capital contribution or a dividend distribution. Exceptions may apply if the transaction and financing are both based on sound business reasons (e.g. if the debt financing is ultimately obtained from a third party) or if the interest is effectively taxed at a sufficient rate (10% in accordance with Dutch standards) at the creditor's level
- Based on the excessive debt financing provision, a taxpayer may not deduct interest expenses relating to excessively financed participations on loans taken out from both affiliated as well as third-party creditors. This to the extent and in line with that the joint acquisition price of (qualifying) participations exceeds the fiscal equity of the Dutch company (the excessive debt). A franchise amounting to EUR 750,000 is provided. Exceptions may apply to loans taken out to finance expansions of operational activities of the group and detailed rules apply to reorganisations
- Finally, under the leveraged acquisition holding regime the deduction is denied for interest on the debt at acquisition company level, insofar as the acquisition vehicle's interest costs exceed the acquisition vehicle's profit on stand-alone basis (tainted interest). The limitation only applies to the extent that: (i) the tainted interest exceeds EUR 1 million or (ii) the acquisition debt exceeds 60% of the acquisition price in the year of acquisition (this percentage subsequently declines by 5% over a 7-year period to 25%). Interest will therefore be restricted if the acquisition company itself does not have sufficient taxable profit to set off the interest and the acquisition debt exceeds the allowed ratio. The limitation of interest deductions will apply to both group and third party interest payments. As per 2017, new anti-abuse rules have been implemented that may further restrict the interest deductibility to tackle the perceived excessive debt financing in private equity acquisitions. These anti-abuse rules have been implemented for (i) the transfer of the target to another "acquisition vehicle" within the group and (ii) debt push down

Please note that the Netherlands is about to implement additional anti-abuse rules (earning stripping rule) following the EU Anti-Tax Avoidance Directive I. Other than the current rules on interest deductibility, the earning stripping rule is of a more general nature. The earning stripping rule will limit the deductibility of the net interest expenses to 30% of a company's EBITDA with a threshold of EUR 1 million. The earning stripping rule will apply for financial years starting on 1 January 2019 or later. ATAD 1 provides grandfathering for loans contracted before 17 June 2016. The Netherlands, however, does not makes use of this possibility. Once the earning stripping rule is implemented, the Dutch Government intends to abolish some of the existing interest deduction limitations, except for the general anti-base erosion provision.

**Acquisition of assets**

There are no specific rules on interest limitations for the acquisition of assets, besides the general concept of abuse of law and the earning stripping rule as of 2019. Please note that the implementation of the earning stripping rule may impact the acquisition of assets.

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

Due to new anti-abuse legislation, various planning structures that were often used to achieve an interest deduction are no longer available following specific anti-abuse rules included in Dutch tax law. Debt push downs may still be effectuated e.g. in case of third party financing. Furthermore, a debt push down can be created to a certain extent by including the leveraged acquisition company and the target company in a fiscal unity. The interest deduction may be limited however based on the leveraged acquisition holding regime.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In the Netherlands it is currently not possible to deduct costs related to equity.

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

Carry forward losses (at the level of the target company) may be restricted as a result of the transfer of the shares in the target company. Under anti-abuse rules the carry forward losses are not available if the ultimate ownership in the target company has changed substantially (30% or more), compared to the oldest loss year, unless an exception applies (e.g. the target company is an active trading company which has not substantially decreased its activities or intends to decrease its activities substantially in the future). A step-up for the amount of hidden reserves can be claimed however if the losses will forfeit due to application of these rules.

Upon a (de)merger, losses can be transferred at a joint request if certain conditions are met. Furthermore, the transfer of losses should be considered upon an exit from a fiscal unity. Losses in principle remain with the parent company, but so called pre fiscal unity losses and losses of the fiscal unity that are attributable to the target company can however be transferred to the target company upon its exit.

Dutch tax payers that qualify as so called holding and financing companies can furthermore be restricted in the use of the carry forward losses if the activities change post-closing and as a result the qualification as holding and financing company alters.

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

Items to be included in the scope of a tax due diligence for a Dutch tax payer (other than the standard market practice scope), include inter alia (i) the presence of a fiscal unity for corporate tax or VAT purposes, as these regimes include specific anti abuse rules that should be reviewed (e.g. interest deduction limitations, claw back

provisions and joint and several tax liabilities) and (ii) the debt financing in place and whether any restrictions to the interest deduction applied historically or will apply going forward. Other items include specific wage tax related matters such as (iii) the presence and consequences of an equity incentive for management or employees and (iv) the historic wage tax treatment of freelancers / hired in staff (which may include a historic secondary liability) as well as benefits in kind. In case the transactions involves real estate located in the Netherlands, it should be reviewed whether the contemplated transaction can result in Dutch real estate transfer tax being due.

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

The Netherlands does not levy capital tax, stamp duties or a minimum tax. If a company is considered as a real estate company, the transfer of shares in the company may trigger a 6% (or 2% in case of owner-occupied housing) real estate transfer tax.

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

Transaction costs will, from a transfer pricing perspective, solely be tax deductible if the party that incurred the costs benefited from the services provided. In practice this rule may limit the possibilities to incur these costs at the level of the target company.

Transaction costs (incurred by the acquiring or selling holding company) related to the purchase or sale of a subsidiary to which the participation exemption applies will not be tax deductible for Dutch corporate income tax purposes. However, costs incurred during the exploratory phase when it is uncertain whether the transaction will take place, or costs related to the financing of the acquisition, such as advisory fees, can be tax deductible. In this regard it is important to carefully document the timing and nature of the costs.

Costs related to the financing of the acquisition are in principle deductible.

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

As a general rule, an acquisition vehicle that solely acts as a holding company post-closing cannot recover any input VAT on acquisition costs related to the purchase of shares. However, under certain conditions a holding company that purchases the shares in the light of future taxable management or advisory services against a remuneration, should be entitled to claim a VAT recovery.

If assets are acquired instead and the holding company continues the enterprise that was carried out through these assets before their transfer, VAT on acquisition costs is only recoverable if it regards a business that performs activities subject to VAT.

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

Non-resident corporate shareholders that fall under the scope of the foreign substantial shareholder regime can be faced with Dutch corporate income tax (max. 25%) on income (dividends, capital gains or interest from a shareholder loan) derived from interests (5% or more) of shares in a Dutch company or membership rights in a Dutch Cooperative.

The current tax legislation stipulates that foreign shareholders/members will be subject to Dutch corporate income tax if (i) the primary objective, or one of the primary objectives, for holding the substantial interest is to evade personal income tax and (ii) this involves an artificial arrangement.

Arrangements are artificial to the extent that they are not put in place for valid commercial reasons which reflect economic reality. In the following safe harbor situations an arrangement is not considered artificial:

**i.** The shareholder/member conducts operational business activities and the shares/membership rights are attributable to that business;

**ii.** The shareholder/member is the top holding company of the group and as such is performing substantial managerial, strategic or financial functions for the group; or

**iii.** The shareholder/member provides a "link" between the Dutch company/Coop and a company as mentioned in the first two bullets, and the shareholder/member has sufficient substance in its home jurisdiction.

The minimum Dutch substance requirements applicable to Dutch holding companies will play a critical role in determining the substance at the level of the intermediary shareholder/member in the jurisdiction of residence. Please refer to question 20 for an overview of the minimum Dutch substance requirements. In addition, as per April 1, 2018 the following substance criteria are also applicable to intermediary holding companies:

- The company incurs annual payroll costs of at least EUR 100,000
- The company has an office space at its disposal for at least 24 months

Similar anti-abuse rules have been introduced with respect to the current domestic dividend withholding tax exemption. In case (i) the primary objective, or one of the primary objectives, for holding the participation is to evade dividend withholding tax or personal income tax at the level of the shareholder and (ii) this involves an artificial arrangement, the domestic dividend withholding tax exemption will not be applicable. The same safe harbor situations apply as with the foreign substantial shareholder regime. Please note that existing tax treaties may prohibit the Netherlands from (partly) applying dividend withholding tax. The implementation of the MLI and the Principal Purpose Test may change this position.

As mentioned in paragraph 1, the dividend withholding tax as such may be abolished as per 1 January 2020. As per the same date a conditional withholding tax on dividends may be introduced and as per 2021 a conditional withholding tax on interest and royalties may also be introduced. The conditional withholding taxes will only be levied in cases of abuse.

Furthermore it is important to review the applicability of the Dutch participation exemption and proper implementation of substance at the level of the Dutch company (the latter is particularly important from the source jurisdiction's perspective).

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

Dutch law provides several facilities to reorganize after the acquisition in a tax neutral environment. Taxpayers can in principle claim a roll-over facility for a merger, a demerger (full or a partial), a business merger and a share-for-share merger. The effect of this roll-over facility is that taxation over any unrealized reserves is deferred because the tax book values are transferred to the acquirer. These facilities may, under circumstances, also apply in cross border situations within the EU/EEA.

Furthermore, Dutch resident corporate tax payers can in principle form a fiscal unity (a tax group) when certain conditions are met. In line with EU case law, a fiscal unity can also be formed between Dutch tax resident companies that have a mutual parent company resident in another Member State of the European Union or by a Dutch resident parent company and a Dutch resident sub-subsidiary that is held by an intermediate company from another Member State of the European Union. Transactions between companies belonging to the same fiscal unity are, mostly, disregarded for corporate income tax purposes (i.e. assets can be transferred to other companies in the fiscal unity without taxation). Claw back provisions may be applicable if a company which has been party to intra-fiscal unity transactions leaves the fiscal unity. Please refer to question 17 for more information on the recent changes regarding the Dutch fiscal unity regime.

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

The transfer of shares in a real estate company can in principle trigger real estate transfer tax. The tax is levied from the purchaser of the real estate company. This means that the transfer of shares in a foreign company, the assets of which consist also of at least 30% Dutch real estate, may be subject to Dutch real estate transfer tax, even if the transferor and/or transferee are non-Dutch residents. The present rate for residential houses amounts to 2% of the sales price (or if applicable the higher fair market value of the real estate). For other real estate not being residential houses, the rate amounts to 6%. A number of exemptions may apply, amongst others in cases where a transfer is subject to VAT (see below) and in the case of restructurings of enterprises.

A company qualifies as a real estate company if:

**i.** 50% or more of the company's consolidated assets constitute real estate, and at least 30% of the assets constitute(d) Dutch real estate

**ii.** at least 70% of the real estate is used for exploitation (i.e. sale / lease) and not for its own offices, production facilities, etc.; and

**iii** the purchaser (in)directly acquires (including any shares already owned) an economic interest of more than 1/3 in the company, in case the acquirer is a company (7% in case the acquirer is an individual) or increases such economic interest

In addition, the depreciation of real estate held by a Dutch corporate tax payer can be limited based on the specific activities of that company.

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

Dutch resident corporate taxpayers can in principle form a fiscal unity when certain conditions are met (e.g. the parent company holds at least 95% of the shares and voting interest in its subsidiaries). In line with EU case law, a fiscal unity can also be formed between Dutch tax resident companies that have a mutual parent company resident in another Member State of the European Union or by a Dutch resident parent company and a Dutch resident sub-subsidiary that is held by an intermediate company from another Member State of the European Union.

The main benefit of a fiscal unity is that profits and losses can be offset by companies included in a fiscal unity. Furthermore, companies can reorganize in a tax neutral way, as transactions between companies belonging to the same fiscal unity are, mostly, disregarded for corporate income tax purposes. Also, only one single corporate income tax return has to be filed.

Anti-abuse provisions may trigger a tax claw back however and should be carefully monitored. In case of a transfer outside the ordinary course of business between companies included in a fiscal unity of an asset that contains a capital gain, a claw-back may arise if the fiscal unity ceases to exist within six years after the transaction (three years in case of a transfer of a stand-alone business for shares). Furthermore, companies included in the fiscal unity remain joint and severally liable to Dutch corporate income tax liabilities of the fiscal unity.

Please note that due to a decision of the European Court of Justice the Dutch State Secretary announced emergency measures to ensure no further base erosion of the Dutch tax base occurs. When the new legislation is introduced the fiscal unity regime will be disregarded in certain situations. This may result in interest expenses no longer being deductible at the level of the fiscal unity. Furthermore, the loss compensation rule and dividend withholding tax rules may become applicable within the fiscal unity. These measurements will become retroactively effective from 25 October 2017. However, for the application of the interest deduction limitation rule under the scope of art.10a DCITA the Dutch State Secretary of Finance granted grandfathering for loans

that already existed on the 25 October 2017 (11 am) until 31 December 2018. Small enterprises (turnover max. EUR100,000) are being exempt from the emergency measures. It is expected that a new group taxation regime will be implemented in the future.

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

The innovation box regulations in the Netherlands aims to stimulate technical innovation and allow companies to have profits derived from (qualifying) intellectual property taxed at an effective tax rate of 7% (before 1 January 2018 the effective rate was 5%).

Per January 2017 some changes have been implemented regarding the innovation box. These changes include the "modified nexus approach" and a distinction between Small and Medium Sized Companies (SMEs) and Large companies, whereby Large Companies should consist of a patent or breeder right in addition to the R&D certificate whereas SMEs only need to have a R&D certificate.

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

The Netherlands levies an exit tax in case of a transfer from tangible and/or intangible assets out of the country. The exit tax as prescribed by ATAD1 will therefore not be included in the Dutch tax law. The exit tax as currently applicable in the Netherlands will be adjusted with respect to the provisions on the deferral of payment of exit taxes. The Tax Collection Act currently provides for a deferral spread over a 10-year period; according to ATAD1 this should not be more than 5 years. For corporate income tax purposes, it has therefore been proposed to shorten the deferral to five years. Another minor change is the term of payment. The deferred tax should now be paid within 5 equal yearly terms.

# 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?

In principle, capital gains derived from the sale of shares or a business are taxed at the Dutch corporate rate of 20-25%. The first EUR 200,000 of profits is taxed against 20%, the remainder up is taxed against 25%. Please note that it is intended to reduce the corporate income tax rate gradually with 4 percent. If it is agreed upon by the Dutch Parliament, the reduction of the rate will be respectively from 20-25%, to 19-24% in 2019, to 17.5-22.5% in 2020 and finally 16-21% in 2021.

Capital gains derived from qualifying participations are however fully exempt under the Dutch participation exemption. The participation exemption is applicable to a share interest of at least 5% in a corporate entity (including a company, mutual fund and cooperatives) and which is not held as portfolio investment. The participation furthermore does not apply to hybrid mismatches (i.e. if the payment has been treated as tax deductible).

If a participation is (deemed) to be held as a portfolio investment, the Dutch participation exemption still applies if the capital interest can be considered a "qualifying" portfolio investment participation. Such a participation is present if one of the following conditions is met:

**i)** The participation is subject to a profits tax that results in an effective tax rate of at least 10% according to Dutch tax standards; or

**ii)** The directly and indirectly held assets of the participation generally consist for less than 50% of low taxed free portfolio investments (i.e. not subject to an effective tax rate of at least 10% according to Dutch tax standards).

Free portfolio investments are assets that are not required for the business of the owner of these assets. Real estate, as well as rights related directly or indirectly to real estate, are in general not considered free portfolio investments.

In principle no minimum holding period applies for the participation exemption. Please note however that the participation exemption still applies to income from a shareholding that at a certain point drops below 5% for a period of three years, but only if that the share interest was held for at least one year during which the participation exemption continuously applied.

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

In general, the taxpayer may defer taxation of the capital gains realized upon disposal of a business asset by forming a reinvestment reserve. Shares may qualify as an asset to which the above described advantage is applicable, provided that the Dutch participation exemption is not applicable on the income derived from these shares (in that case no fiscal advantage is required as all income is tax exempt). If the proceeds realized upon disposal exceed the book value of the assets, the taxpayer may form a reinvestment reserve for the excess if, and so long as, the company intends to reinvest this amount. The amount for which the investment has been formed must generally be reinvested no later than within three years after the year of disposal. Various anti-abuse rules apply with respect to this regime.

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

In principle, corporate entities incorporated under Dutch law, such as a limited liability company (a BV), are considered a Dutch resident corporate taxpayers, regardless of the level of substance in the Netherlands. It is however key that the company's effective management takes place in the Netherlands, and not in another state, to avoid dual residency issues. It is advisable that a company is not only effectively managed from the Netherlands but that also the Dutch minimal substance requirements are met.

Substance requirements apply to companies that qualify as so called "financial service companies' (i.e. its activities consist for at least 70% out of intra-group financing or licensing activities) as well as companies that request an Advance Pricing Arrangement or Advance Tax Ruling ("APA/ATR") from the Dutch tax authorities.

The current minimum Dutch substance requirements are as follows:

- At least 50% of the board of the statutory (and competent) directors should be resident in the Netherlands.
- The directors of the company should be qualified, in order to be able to properly perform their duties.
- All key management decisions are taken in the Netherlands.
- The entities' principal bank accounts must be kept in the Netherlands.
- The bookkeeping / audit activities take place in the Netherlands.
- The company meets at any time its filing obligation for all tax returns (i.e. VAT, Wage Tax, and CIT).
- The business address and registered office of the company are located in the Netherlands.
- To its best knowledge, the company is not considered a tax resident in any other country.
- Companies carrying out finance, licensing or leasing activities should be exposed to a certain minimum risk (e.g. no full non-recourse provisions) and have sufficient equity to cover those risks.
- Subsidiaries held by holding companies are financed for at least 15% with equity.

If these conditions are not met the financing/licensing/holding company risks that the Netherlands will spontaneously exchange information to the relevant tax treaty partner or EU Member State. This risk will also apply on existing companies and therefore they also will have to meet the (increased) substance requirements.

Please note that the additional substance requirements as mentioned in paragraph 14 may also become applicable to these so called "financial service companies" as well as to companies that request an Advance Pricing Arrangement or Advance Tax Ruling ("APA/ATR") from the Dutch tax authorities.

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

Dutch law provides several facilities to reorganize in a tax neutral environment at two levels (i.e. for the Dutch tax resident shareholders and for the (de)merging entities), in line with the EU Merger Directive. Taxpayers can in principle claim a reorganization facility in case of a merger, a demerger (this can be a full legal demerger a partial legal demerger), a business merger and a share-for-share merger. These reorganization facilities may, under circumstances, also apply in cross border situations within the EU/EEA.

The reorganization facilities can in principle be claimed by law. In certain situations however (e.g. if the entities involved report carry forward losses, claim a reduction to avoid double taxation or apply the innovation box regime), the reorganization facility is only applicable under additional conditions and parties involved should file a request for the applicability of the reorganization facility to the Dutch tax authorities. Please note that a reorganization facility will not be granted if the reorganization is not based on business reasons, such as a valid restructuring or rationalization of the corporate structure, but is (mainly) aimed to avoid / postpone taxation. It is possible to request the Dutch Tax Authorities in advance for certainty that the reorganization is based on sound business reasons. A denial of such request is open to appeal.

As a result of the reorganization facility, the entity receiving the assets/shares will value these at the original book value as reported by the transferring entity. The tax claim is therefore postponed and possible claw back should be carefully monitored during future reorganization (e.g. a claw back may arise if the acquiring entity is sold within three years after the reorganization took place).

In case a real estate company is merged (please refer to question 16 for this definition), this may lead to real estate transfer tax. However tax exemptions may be available for mergers / spin-offs provided that specific circumstances are met (e.g. requirement to retain the real estate for three years). If such requirements are not met a claw-back may apply. Certain intragroup reorganizations (e.g. another merger) are however permitted without triggering this claw back.

For VAT purposes, there are no formal facilities that can be claimed. It needs to be reviewed on a case-by-case basis whether a merger or spin-off can for example be considered outside the scope of VAT as the transfer of a totality of assets.

## MANAGEMENT INCENTIVES

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

Tax consequences in the Netherlands in respect of management incentives differ depending on the characteristics of the incentive plan. The general rule is that income earned is subject to wage tax that is to be withheld by the employer. With respect to straight forward employee incentive plans (i.e. stock options, stock appreciation rights and restricted stock units) the taxable moment is the moment when the rights are exercised and the employee receives the shares or cash. Taxation may also incur at the moment the incentive is granted to the employee. However, this is for example only the case when the employee receives the full economic and legal ownership at grant. In some cases, a discount can be applied for tax purposes if the shares are restricted in a certain manner.

For shareholdings of managers (carried interest structures), e.g. in private equity related structures, specific anti-abuse legislation is applicable in the Netherlands. Subordinated shares which constitute less than 10% of the total share capital or preference shares with a preference of more than 15% are considered a lucrative interest. However, also other shareholdings, loans or any other rights, of which the valuation increase can be seen as remuneration for the managers' activities, can be considered lucrative under this legislation (i.e. shareholdings with multipliers, ratchets, etc.). Based on the anti-abuse legislation, any income derived from such lucrative interest are taxable as other income against the progressive tax rates of max. 52% (instead of being taxed as income from savings and investments). Upon setting up such structures it is recommendable to gain advice in order to reduce any unforeseen tax risks.

## FOR MORE INFORMATION CONTACT:

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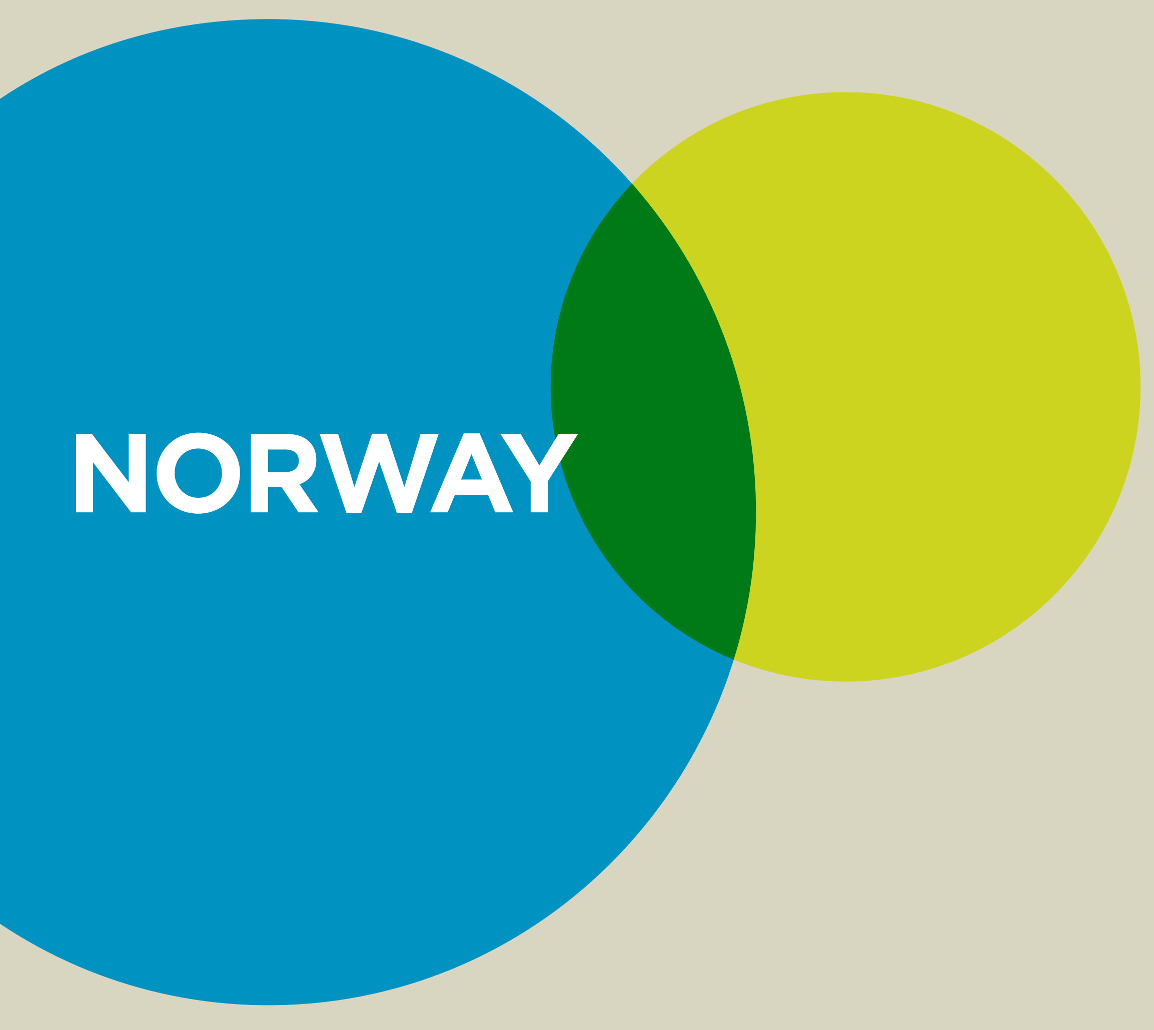

# NORWAY

# NORWAY

## INTERNATIONAL DEVELOPMENTS

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

The general rate on income tax has been reduced from 27% in 2015 to 23% in 2018. It is currently not expected that the tax rate will be reduced further.

The Ministry of Finance has proposed extending the scope of the Norwegian interest deduction limitation rule to also include interests to external parties. The new rules was planned to be introduced with effect from 2018, but due to several objections, they were postponed. An amended proposal is expected to be proposed in 2018, with effect from 2019.

The proposal from last year implies that the deduction of interests paid to non-affiliated lenders may be denied for tax purposes if certain criteria are not met. The rules apply if net interest costs are higher than NOK 10 million at Norwegian group level (what constitutes a Norwegian group is defined under the legislation). The ministry proposed safe harbour rules in order to safeguard against loans, which are not tax motivated or artificial, but the rules were criticised for not being accurate enough. Please see question 6 for further information.

The Norwegian Ministry of Finance will most likely publish a proposal on withholding tax on interests and royalties within the end of the year. Amendments to the Norwegian CFC legislation may also be published, but that is more uncertain.

### 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?

Generally, Norwegian authorities are positive to the implementation of the OECD BEPS actions. With respect to BEPS action Plan 6, the Norwegian Ministry of Finance has announced that they will implement the "Principle Purpose Test" (PPT) in Norwegian tax treaties for the avoidance of treaty shopping.

Norway has signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI") (action Plan 15). The Norwegian Ministry of Finance has announced that it wishes 28 bilateral tax treaties to be covered by the MLI.

Below is an abstract of some of the positions Norway has taken with respect to the different options available under the MLI:

- Article 4 – Dual Resident Entities: Norway has reserved the right for the entirety of Article 4 not to apply to its covered tax treaties that already address cases where a person other than an individual is a resident of more than one contracting jurisdiction by requiring the competent authorities of the contracting jurisdictions to endeavour to reach mutual agreement on a single contracting jurisdiction of residence, and that set out the treatment of that person under the covered tax treaty where such an agreement cannot be reached. This reservation applies to Bulgaria, Chile, Cyprus, Estonia, Latvia, Lithuania, Romania, Serbia and United Kingdom
- Article 5 – Application of Methods for Elimination of Double Taxation: Norway has chosen to apply option C of the Article.
- Article 7 – Prevention of Treaty Abuse: It is expected that the principal purpose test (PPT) will be introduced in 28 Norwegian tax treaties. Among six of these tax treaties, also a simplified limitation on benefit provision (LOB) is expected to be introduced (in addition to the PPT). However, the Norwegian authorities have expressed that while Norway accepts the application of Article 7(1) (PPT) alone as an interim measure, it intends where possible to adopt a limitation of benefits provision, in addition to or in replacement of Article 7(1), through bilateral negotiation. Norway has chosen to apply Article 7(7)(a)

- Article 9 (Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property) and 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions): Norway has reserved the right for Article 9(1) and the entirety of Article 10 not to apply
- Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions: Norway has chosen to apply Option A under paragraph 1
- Article 14 – Splitting-up of Contracts (relating to permanent establishment): Norway has reserved the right for the entirety of the Article not to apply with respect to provisions of its covered tax treaties relating to the exploration for or exploitation of natural resources.

## GENERAL

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

**A) Share deal**

Most deals in Norway are carried out as share deals. A share deal is not a taxable event for the target company, meaning that there will be no taxation of the target company's underlying assets, and there will be no stamp duty. In addition, capital gains on shares are tax exempt for corporate shareholders, and there is no stamp duty on the transfer of shares. Thus, a share deal will not have any (direct) tax consequences.

However, tax loss carry-forward at the level of the target company/group may lapse if the main purpose of the acquisition of the shares is to utilise the tax loss carry-forward.

**Tax advantages:**

- Not a taxable event for the target company
- Not taxable for seller
- No transfer taxes or stamp duty

**Tax disadvantages:**

- Any existing tax liabilities in the target company will continue to exist
- The buyer will normally demand a discount for lost depreciations on the target's assets
- No step up for the purchase
- Most acquisition costs are not deductible

**B) Asset deal**

An asset deal is a taxable event, which implies that all assets and liabilities of the business are considered to be realised for tax purposes. Gains are taxable at a rate of 23%. Losses are deductible. Because an asset deal is a taxable event a purchase price allocation must be prepared. The allocation will be the basis for the calculation of taxable gain/loss.

Taxation of capital gains related to assets and goodwill may be deferred through special rules. Tax deduction for losses must be deferred. Normally, gains/losses are booked at a profit and loss account, where 20% shall be booked as income/loss per tax year on a declining balance basis. This only applies with respect to tax and not for accounting. Thus, there will be a temporary difference between the tax and the accounts.

Furthermore, a purchase price allocation must be prepared by the buyer. The purchase price allocation will be the basis for tax depreciation. Normally, the tax depreciation will be slower than the seller's deferral of gains.

**Tax advantages:**

- Step up for the purchaser
- No tax liabilities transferred from the seller
- Acquisition costs usually deductible, however, often through depreciation

**Tax disadvantages:**

- Fully taxable (some gains may be deferred)
- Stamp duty on real estate.

## 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?

It is not possible to get a step up on the value of the tangible and intangible assets in a share deal.

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

Purchased goodwill (e.g. through a direct acquisition of business) may be depreciable at a rate of 20% on a declining balance basis. Goodwill which is created by the taxpayer is not subject to depreciation for tax purposes.

### 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?

There are rules limiting the deductibility of interest costs to related parties. The rules apply if net interest costs per tax entity exceed MNOK 5. Net related party interest costs are deductible within 25% of the tax entity's tax EBITDA. Net non-related party interest costs are also deducted from the 25% tax EBITDA, and will therefore reduce the maximum related party deduction. If a non-related party loan is guaranteed by a related party, the interest costs may be reclassified as related party debt.

In accordance with the BEPS initiative, the Ministry of Finance has proposed to extend the current interest deduction limitation rule to also include external interests. For Norwegian tax entities, which form part of a group, interest expenses on external debt will also be subject to limited interest deductions (25% of EBITDA). The rules will apply if all of the Norwegian tax entities within a group have net interest costs of more than MNOK 10. Two safe harbour rules have been proposed, under which a company or the Norwegian tax entities of a group may fully deduct interest costs (related and non-related);

1. The relevant company on a stand-alone basis has a debt to equity ratio similar to or a higher equity ratio than the consolidated debt to equity ratio in the group which the company is a part of (defined by financial accounting rules)
2. The Norwegian part of the group has a consolidated debt to equity ratio which is similar to or a higher equity ratio than the consolidated debt to equity ratio in the wider group (defined by financial accounting rules)

After the proposal went on public hearing last fall, it was decided that amendments were necessary. An amended proposal is expected later this year, with the new legislation planned to come into force from 2019.

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

Typically, a Norwegian holding company ("BidCo") is used as an acquisition vehicle. Norway applies group contribution rules, implying that the target company can contribute equity to the holding company with tax deduction in order to net the tax loss (resulting from interests) in the holding company. Please see section 17 for further information.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are generally no tax incentives for equity financing in Norway.

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

As a main rule, losses are available also after an acquisition is carried out. However, if tax positions in the target company are unrelated to any asset or liability, and the exploitation of such tax position is the main purpose of the acquisition of the target company, the tax positions will lapse. The legislation will normally only be relevant if the target company is included in a tax group through the acquisition (more than 90% shares and votes) and the losses may be utilised by the other companies in the tax group.

## 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 items are very specific to Norway. Similar to other countries, incentive schemes for management, debt push down, tax-exempt reorganisations, etc., are important matters to consider in a due diligence. Thus, we recommend that these matters are included in the scope/request list.

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

There are no indirect taxes, stamp duties or similar on transfer of shares.

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

Typically, most acquisition costs for share deals will not be deductible. The nature of the costs must be assessed. Costs related to financing are normally deductible. Acquisition costs related to asset deals shall typically be capitalised on the purchased assets, and deducted through depreciation.

The costs related to the acquisition of the target company shall be capitalised on the shares in target. As capital gains on shares for corporate shareholders are tax exempt in Norway, the acquisition costs will be non-deductible. The typical acquisition costs are costs to due diligence, estimation of value, contract negotiation etc. However, certain costs related to an acquisition are still deductible, being costs related to;

- incorporating BidCo
- financing the acquisition
- the structuring of the corporate structure of the acquisition
- the preparation of the corporate documents and meetings (minutes from board meetings etc.)

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

In share deals, it is usually not possible to recover such VAT. However, in extraordinary situations it may be argued that VAT on such acquisition costs are deductible if the costs are used in and closely connected to the buyer's VAT applicable business.

In asset deals, it is often possible to recover such VAT, however depending on the assets transferred, how the assets will be used after the transfer, and the VAT status of the buyer.

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

Yes. There is withholding tax on dividends and an acquisition should therefore be structured in a way that eliminates the withholding tax. It is preferable to utilise a holding jurisdiction where there is both domestic ("substance requirement", see 22 below) and treaty protection ("beneficial owner").

Furthermore, repayment of paid-in capital is not subject to withholding tax in Norway, and distributions from Norwegian companies should be structured as repayments of paid-in capital (and not dividends) in order to avoid or postpone withholding tax on distributions. Moreover, capital gains are not subject to withholding tax in Norway, and a repayment of paid-in capital, which increases a later capital gain upon a realisation of shares, will thus be more tax advantageous from a Norwegian perspective than dividends being subject to withholding tax.

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

Yes. There are rules that provide for tax neutral reorganisations. However, there are anti-avoidance rules that could be applicable if the sole purpose of the transaction is tax motivated.

In addition, restrictions in the Norwegian company law may apply, e.g. if the acquisition debt will be placed in the acquired company through the reorganisation.

Furthermore, a cross border merger/demerger may lead to exit taxation if the business/assets is/are exited from Norwegian tax jurisdiction.

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

There is a stamp duty of 2.5% of the fair market value of transferred real estate if an asset deal is carried out. There is no stamp duty triggered upon the transfer of shares, even if the main assets of the company are real estate. Therefore, it is normal to organise real estate in (single purpose) companies and to sell shares rather than assets, implying that the seller avoids both capital gains taxation (due to the exemption method) and stamp duty.

The seller must normally give the purchaser a tax rebate if a real estate is sold through a share deal. The rebate is linked to the lost step up at the hand of the purchaser (lost tax depreciation). The rebate is calculated as a percentage of the difference between the property value (after the deduction of the estimated market value of the land) and the basis for tax depreciation on the property as per closing (typically 9–10% for buildings with a 2% depreciation rate on the building and 10% on technical installations).

Several municipalities have introduced property tax on the value of real estate. In the municipality of Oslo, the property tax is 0.2%. Thus, the element of property tax should also be taken into account.

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

The Norwegian Tax Act allows tax consolidation between group companies which are taxable in Norway provided that the parent company holds more than 90% of the shares and votes in the subsidiary, and in case of indirect ownership, each company in the structure holds more than 90% of the shares and votes in the relevant company's subsidiary ("Tax Group"). A company that has taxable profit may transfer its taxable profit to another group company to offset against tax losses. Both horizontal and vertical consolidation are accepted provided that the donor and recipient belong to the same Tax Group.

The parent company may be resident in another state; however, as a main rule this does not apply in case the parent company is the donor or recipient of the relevant group contribution. Nevertheless, the donor and/or the recipient may be resident in another EEA state if:

**i.** the foreign company corresponds to a Norwegian company qualifying under the tax consolidation rules

**ii.** the foreign company is liable for tax in Norway for having a permanent establishment here or pursuant to section 2, cf. section 1, of the Petroleum Taxation Act; and

**iii.** the received group contributions constitute taxable income in Norway on the part of the recipient

Also if the recipient is a company within the EEA as mentioned in letter i. and the recipient has tax loss carry forward from business conducted in Norway, tax consolidation is also accepted to the extent the amount is not exceeding the loss carry forward of the recipient.

For VAT purposes, it is possible to register a group together, provided that the top company holds at least 85% of the shares in the subsidiaries.

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

Norway does not have any special status for companies that hold intangible assets.

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

Transfer of assets, including ownership of intangibles, is regarded as realisation for tax purposes, and gains are taxable at a rate of 23%. Losses are deductible and must be deferred. Gains may be deferred. These rules also apply if ownership of intangibles is transferred out of Norway. Normally, gains/losses are booked at a profit and loss account, where 20% shall be booked as income/loss per tax year on a declining balance basis (only for tax purposes, see further under section 3 b above).

Also, if a company's tax liability to Norway is discontinued pursuant to Norwegian legislation or if the company shall be deemed to be resident in another state under a tax treaty (an exit event), any gains and losses on assets (including intangibles) owned by a company, shall be taxable or deductible as if such assets were realised the last day before the tax liability to Norway was discontinued (exit taxation). The output value shall be equal to the assets' market value.

For a company that becomes tax resident in another EEA-state which is not regarded as a low-tax jurisdiction or in another EEA-state which is regarded as a low-tax jurisdiction and the company is genuinely established and performs real economic activity in that EEA-state, only assets and liabilities that are removed from Norwegian tax jurisdiction upon relocating abroad shall be subject to exit taxation. The taxpayer may claim deferral of such exit tax; however, the tax shall nonetheless be paid with one seventh of the original tax amount for each tax year with effect from the exit year.

## 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 on shares are fully tax exempt for corporate shareholders, foreign and domestic, and there is no withholding tax on capital gains. Other capital gains are usually taxable at a flat rate of 23%. It is possible to obtain tax deferral on capital gains from sale of business assets. Normally, gains may be booked at a profit and loss account, where 20% shall be booked as income per tax year on a declining balance basis (only for tax purposes, see further under section 3 b above).

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

There are no fiscal advantages if the proceeds from the sale of shares are reinvested.

**Are there any local substance requirements for holding companies?**

There are no substance requirements for domestic holding companies. However, the holding company must have effective management in Norway in order to meet the tax residency test.

Foreign holding companies are subject to Norwegian withholding tax of 25% (which may be reduced by tax treaty) on dividends distributed from Norwegian companies. There is a domestic exemption for distribution to shareholders domiciled within the EEA. If the establishment of the holding company in the other EEA state does not lead to any tax advantages compared to an establishment of a holding company in Norway, the withholding tax exemption shall apply. If the establishment in the other EEA state may lead to tax advantages, the withholding tax exemption will not apply if the subjective purpose of the establishment solely was to obtain a tax advantage. The subjective purpose shall be determined based on objective circumstances.

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

With regard to mergers and spin-offs it is important to take into account any VAT adjustment obligations. In mergers and spin-offs (demergers), it is important that the VAT adjustment obligations are transferred to the acquiring company. The VAT adjustment period for real estate investments is for example 10 years.

## MANAGEMENT INCENTIVES

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

There are no particular tax benefits applying to management incentive plans. A share option is however, not deemed as taxable income before it is exercised, in which event the entire benefit (gain on the option) is considered as employment income for the tax payer.

An employer may offer up to 20% discount on shares, provided that the shares are offered as a general scheme to the employees in the company. The total (annual) benefit for each employee cannot exceed NOK 3,000 (EUR 320).

There is also a special scheme for employees in start-up companies. Under the scheme, the taxation of taxable profits on options shall be postponed until the shares (received) are realised, and not when the options are exercised. Several conditions must be met for the special tax treatment to apply, and the rules are therefore unpractical. The tax deferral only applies to taxable profit up to a limit of NOK 500,000 per employee.

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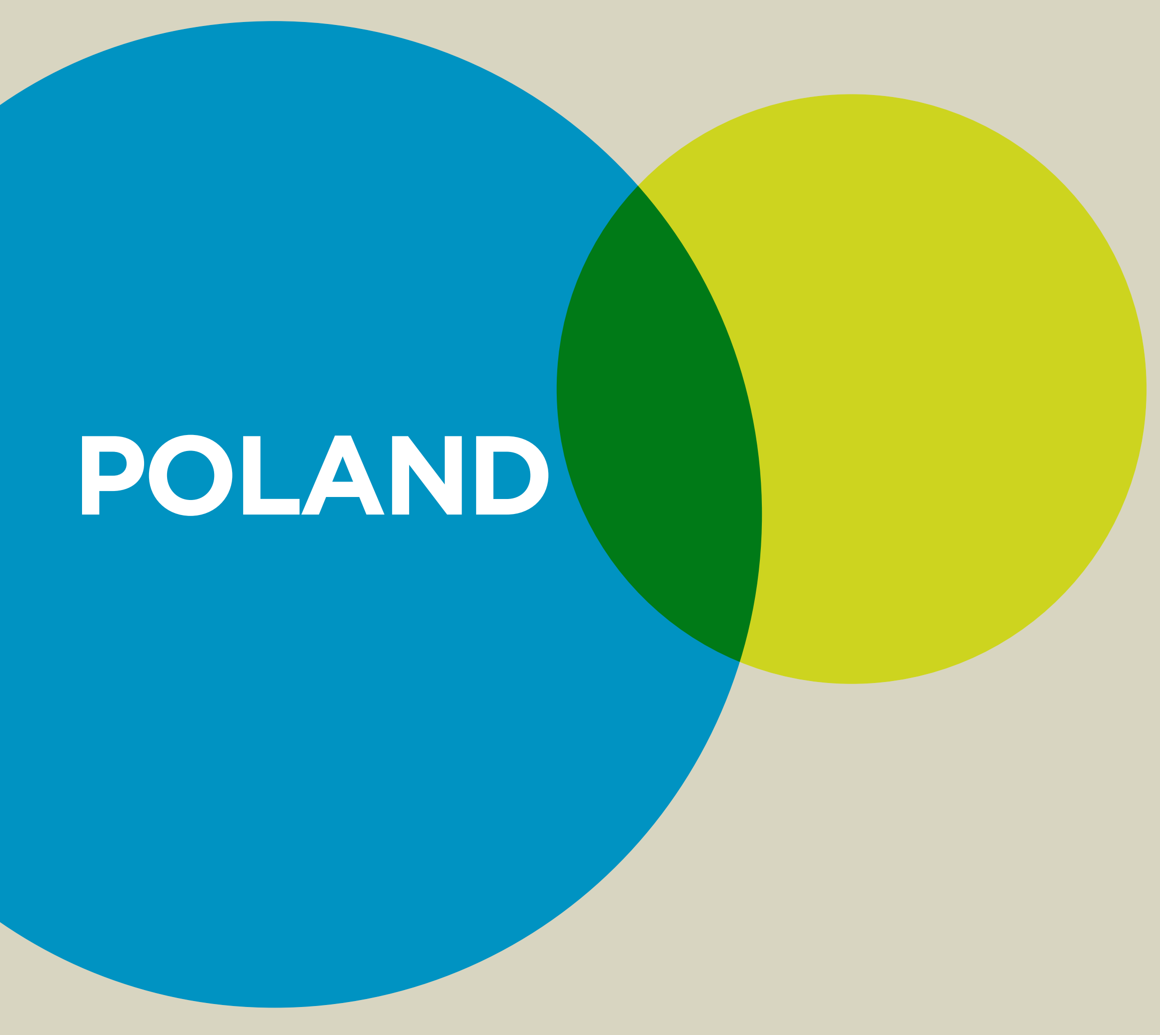
# POLAND



# POLAND

## INTERNATIONAL DEVELOPMENTS

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

In 2018 Poland introduced a number of tax changes. The most important ones which may be relevant for M&A are as follows:

- Source of revenue: Division of operation profits and capital gains resulting in closing the possibility to mix income/losses from different sources. Capital gains catalogue includes in particular profits from: mergers and demergers, in-kind contributions, redemption of shares (and other decrease of their value), liquidation proceeds, retained profits, sale of shares, share for share exchange, sale of receivables previously acquired by the taxpayer and receivables resulted from the capital gains, certain property rights (e.g. licences), securities and derivatives connected with capital gains
- Thin capitalisation: Tax deductibility of financial costs (including interest) exceeding PLN 3m is limited up to 30% tax EBITDA. The regime refers to the debt financing from both related and non-related parties (including banks). Non-deductible debt financing costs have to be attributed to a particular source of revenue. Costs non-deductible in the given year may be recognized during 5 subsequent years. Additionally, if the taxpayer's debt financing costs exceed the value of financing which the taxpayer could obtain if the financing is granted by non-related parties (taxpayer's market creditworthiness), the tax authorities may determine taxpayer's income or loss differently than declared by the taxpayer
- Debt push-down: Excluding (entirely, irrespectively of thin capitalisation regime) from tax deductible costs interest paid on (group and external) financing granted for the acquisition of shares if, as a result of post-trade operations (e.g. merger), they are deducted against operating income of the acquired company (debt push-down mechanism). The new restrictions could cover interest on loans granted before the new law entered into force
- Intangible services: Tax deductibility of expenses for certain intangible services acquired from related parties exceeding PLN 3m is limited to 5% tax EBITDA. This refers to advisory, marketing, market research, management, data processing, insurance, guaranties and other of similar nature. The limitation covers also payments for certain intangible and legal assets (e.g. licenses, copyrights). Costs that were not deductible in the given year may be recognized during 5 subsequent years
- Profit participation exemption: Profit participation exemption is limited only to profit distributions (e.g. dividends). Liquidation of a Polish subsidiary or redemption of shares is no longer tax exempt.

### 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?

Generally, Poland supports OECD BEPS actions. In respect to OECD BEPS Action 6 the Polish Ministry of Finance is renegotiating some double taxation treaties (DTTs). In particular, Poland's efforts are targeted at eliminating from DTTs tax sparing credit clauses and introducing artificial arrangement, real estate anti-abuse as well as beneficial ownership clauses. Among the DTTs which are subject to negotiation / renegotiation or are planned to be renegotiated are the DTT with Brazil, Philippines, France, Kuwait, Morocco, Russia, Spain, the Netherlands and Thailand. It is assumed that further adjustments of Polish DTTs with other countries could be made as part of the implementation of a multilateral instrument (Action 15) described below.

As regards OECD BEPS Action 15, Poland is an active member of the OECD Group Developing a Multilateral Instrument to Modify Bilateral Tax Treaties.

In this regard, the key areas for Poland are:

- change of the method of avoiding double taxation from exemption with progression to tax credit
- introduce principle purpose test (possibility to question transaction with foreign party by the tax authorities if the transaction aims only to achieve the tax benefit); potentially within bilateral negotiations - introduction of limitation on benefits)
- introduction of real estate clause

Poland signed the convention on the ceremony which took place in June 2017.

Poland implemented a number of changes to the Polish tax scheme based on the Anti Tax Avoidance Directive (regarding e.g. introduction of tax baskets, thin capitalization, CFC regulations). It is also planned that exit tax will be introduced.

## GENERAL

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

**A) Share deal**

From the buyer's perspective share deals do not allow the buyer to achieve step-up on the value of assets of the target company. At the same time by acquiring shares in the target company, the buyer acquires an entity with all its potential tax liabilities, Net Operating Loss (NOL) for a year of acquisition and unsettled losses from previous years (no change of control rule). There is no legal possibility to cut off the liability of the target company from its tax liabilities arisen prior to acquisition.

Expenses incurred on acquisition of shares (e.g. price paid) constitute tax deductible cost (capital gain basket) on the date of disposal of the shares, while interest on the loan for purchase of shares are in general regarded as tax deductible costs when paid based (not on accrual basis) on the current approach of the tax authorities.

The acquisition of shares in a Polish company triggers obligation of payment of Tax on Civil Law Transaction (TACL). The tax at the rate of 1% is charged on the acquisition value of shares. Acquisition of shares in foreign company by a Polish entity will also fall within TACL taxation if the SPA is concluded in Poland.

From the seller's perspective both sale of shares and sale of assets are taxable events. Any income realized on the transactions (capital gain basket) is subject to a standard 19% CIT rate. In both cases, income realized on disposal may be off-set with losses of the seller (from capital gain basket only), if there are any available. It should be also noted that with respect to certain R&D companies, capital gain on the disposal of its shares may be exempt under certain conditions. In practice, if share deals are contemplated for the transfer of a Polish target, the transaction is usually effected from the level of the seller located in a typical holding jurisdiction (where participation exemption regime exists) or through Polish Closed End Investment Fund.

**B) Asset deal**

From the buyer's perspective the general result of a concluding an asset deal is that the purchase price paid will constitute tax depreciation base as well as tax cost basis (decreased by the depreciation write-offs made by the buyer) for the future sale of assets.

The acquirer of assets may be held responsible for tax liabilities of the seller in case the assets constitute an enterprise or its organized part. The liability may be effectively limited or excluded if the buyer obtains from the tax authorities a specific certificate disclosing tax liabilities and pending penalties due by the seller. In such a case, the buyer may not be held responsible for tax arrears and other dues not revealed by the certificate.

Transaction regarding the sale of business assets are generally subject to VAT (currently 23% standard rate). As long as the buyer runs VAT-able activity, VAT charged upon acquisition should be effectively neutral. Input VAT incurred upon acquisition may be utilized via deduction from output VAT or direct refund.

Certain transactions may fall outside the scope of VAT (enterprise or organized part of thereof; “OPE”), or be exempt from VAT (e.g. certain types of real estate). Sale transactions falling outside the scope of VAT and transactions regarding real estate and shares which are VAT exempt are subject to TACL. The rates of TACL vary from 1% to 2% of the market value of assets (meaning usually purchase price).

From the seller’s perspective a sale of assets is generally subject to 19% CIT on the difference between the price obtained and the net asset value.

Sale / purchase of assets should generally fall into operating income basket. However, in particular in case of the sale of the enterprise or its organized part, the detailed analysis would be required in order to assess if certain assets may fall into capital gain basket.

## 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?

Generally share deals do not result in a step-up in the value of assets of the target company. Certain possibilities in this regard exist after the transaction (such as transferring of the assets from a SPV to another entity through liquidation), any such process, however, should be strongly grounded with a business justification.

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

Goodwill is depreciable only if it has arisen as a result of an acquisition of an enterprise or an OPE through purchase, leasing enterprise under financial lease agreement (under additional conditions) or contribution in kind of an enterprise under the specific provisions on commercialization and privatization. Goodwill revealed upon acquisition of shares in the company or contribution in kind of company’s enterprise is not depreciable.

If goodwill is depreciable, it may be written-off for tax purposes over a period of 60 months (5 years) i.e. at 20% annual rate. The taxpayer may prolong depreciation period and reduce yearly rate. In any case depreciation period and rates should be determined before commencement of depreciation write-offs.

### 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?

Interest on debt used for financing the purchase of assets or shares of a target company as a rule may be tax deductible.

It must be noted that under the Polish domestic law interest is deductible on cash (i.e. upon payment, off-set, capitalisation) and not accrual basis. Interest on debt financing acquisition of fixed assets accrued until the date of delivery for use are capitalised to the initial value of assets for tax depreciation purposes

However, the following restrictions regarding tax deductibility of interest may arise:

- Thin capitalisation restrictions: For the financing granted (and funds received) in 2015-2017: thin capitalisation regime for given debt can be determined under one of two methods: standard, i.e. when interest on indebtedness exceeding 1:1 debt to own equity ratio are not tax deductible if granted by a related entity or an alternative which takes into account (i) the tax value of assets, (ii) the value of profits and (iii) the nominal interest rate announced by the National Bank of Poland. In particular, under the alternative method the amount of tax deductible interest resulting from loans granted by related and non-related parties (e.g. bank) is limited to the tax value of assets (excluding intangibles) multiplied by the reference rate of the National Bank of Poland (currently 1.50) increased by 1.25 percentage points and 50% of the profits resulting from the operating activity in the given tax year. In order to choose this alternative method, a written notification should be submitted before the tax authorities. Afterwards, it has to be apply by given taxpayer for a minimum period of three years.

For the financing granted (and funds received) from 2018 the new rules are applicable (please refer to the point 1). However, "the old rules" will be in force only up to the end of 2018. From 2019 the taxpayers will be obliged to use new method even for old financing.

- Interest on debt push-down is tax non-deductible (please refer to the point 1).
- The tax treatment of the takeover of debt and payment of related interest is not regulated by the provisions of Polish CIT law. Therefore tax consequences of such operations should be carefully analysed case by case
- CIT law provides that interest on own capital invested by the taxpayer in a source of his revenue does not constitute a tax deductible cost. This limitation covers loans granted to partnerships by their direct partners, proportionally to their participation
- In addition, transfer pricing adjustments may be also applied if the financing terms agreed by taxpayers performing transactions with related entities differ from market conditions limiting the amount of tax deductible costs
- Last but not least, there is a growing tendency among tax authorities to examine the capacity of an entity to draw a corporate debt and to discuss if it should be regarded as debt or rather as equity. We expect this approach will be continued despite new limits discussed above.

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

A typical strategy to push-down a debt is a post-acquisition merger: The Polish SPV draws the debt for the acquisition of the target, buys the target and subsequently merges with it. Another strategy could be an acquisition of assets of the target company financed by debt (e.g. a loan granted by an affiliated company or a third party bank) or transformation of the target into tax transparent partnership.

It should be stressed that Poland has not introduced any specific anti-abuse provisions regarding the merger of the entity acquiring shares with the target (apart from the general merger anti-abuse clause). However, the tax authorities may challenge such structures based on the General Anti Avoidance Rules being in force in Poland since July 2016.

Tax deductibility of interest on acquisition financing in the case of a post-acquisition merger is denied.

Somewhat less frequently used strategies are the establishment of a Tax Capital Group (TCG) or consolidation with tax transparent partnerships.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Currently there are no provisions in Polish tax law that would allow for tax incentives for equity financing.

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

Generally, in the case of the acquisition of assets of the target company, the NOL and unutilised losses of the target company remain with the seller. In the case of the acquisition of shares of the target company, change of control does not have an impact on tax losses carried forward and NOL of such company arisen prior to acquisition may be off-set against its taxable income for the given fiscal year of acquisition or carried forward (based on tax baskets rule). The losses incurred and not utilised in a given tax year may be carried forward and used for tax purposes during 5 consecutive years. The maximum amount that can be utilised in each of these years is 50% of each tax loss. There are no specific anti-abuse provisions limiting this possibility. However, tax losses reported before 2018 are subject to previous provisions with no allocation to tax baskets.

Certain restrictions on utilisation of losses exist in respect to specific forms of transfer of assets. In particular losses of entities disappearing within the framework of a merger, spin-off, liquidation or division are lost for tax purposes. Also losses of transformed entities are forfeited (unless transformation involves transformation of one type of capital company into another type of capital company).

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

Certain Polish specific tax rules are provided with respect to (i) companies operating in the Special Economic Zones or (ii) companies benefiting from certain R&D reliefs. Besides, there are certain business specific risks that should be carefully checked, for example, the risk of VAT fraud in businesses such as the sale of electronics or raw materials, or settlements of the acquisition of real estate by a real estate company for tax purposes (whether it is subject to VAT or TACL). Also, due to recent significant changes in the tax authorities' approach in Poland in the last two years, one should also carefully analyse any reorganisations performed by the target (in particular in kind contributions, mergers, spin-offs, exchange of shares, in particular those where a tax loss was declared).

Additionally, in a due diligence one should also put extra effort to analyse the transactions with related parties as tax authorities currently very diligently examine the conditions upon which they are performed and if the new Transfer Pricing requirements with respect to documentation are met.

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

The acquisition of shares of a Polish target is subject to 1% TACL payable by the buyer (regardless if the buyer is a Polish or a foreign entity). In certain cases i.e. when the acquisition is performed via foreign or Polish investment enterprises, or a stock-listed company is subject to acquisition, the transaction may be TACL exempt.

The tax base is the market value of shares transferred. Transactions on shares in foreign entities as a rule are not taxed with TACL in Poland (unless the acquirer is a Polish entity and the transaction is performed in Poland i.e. the contract is concluded in Poland).

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

Costs related to the acquisition of shares are in general tax deductible. However, expenditures which are necessary to incur to conduct the transaction such as TACL paid on the purchase price or notary fees become tax deductible costs when the shares are sold. Other acquisition costs of shares such as legal or financial advisor fees are deductible when they are incurred.

Acquisition costs related to the purchase of assets are as a rule capitalised into their initial value and deducted through depreciation.

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

In general, the acquisition of shares under Polish VAT Law is not subject to VAT, thus as a rule, VAT on acquisition costs is not recovered unless the acquisition of shares is made in order to effectively participate in managing the target.

However, VAT related to expenditures linked with mergers, acquisitions, divisions or the changes of the legal form of a business is deductible provided that these expenses have been incurred in connection with a planned or carried out business activity being subject to VAT.

Transactions involving assets are generally subject to Polish VAT. VAT related to the purchase of assets and other linked expenditures is deductible provided that these expenses have been incurred in connection with a planned or carried out business activity being subject to VAT. If a deal is structured as a sale of an organised part of the enterprise (a going concern), such supply is out of scope of Polish VAT. Recently a negative trend of the tax authorities has been noticed with regard to reclassifying transactions involving the sale of commercial real estate, from a supply of goods subject to VAT to a supply of an organised part of the enterprise (a going concern) which is not subject to VAT. Starting in 2016, the tax authorities carried out a number of audits and made such reclassification of transactions. As a consequence, the tax authorities stopped VAT refunds. The actions of the tax authorities caused also the necessity to tax the sale of real estate with 2% tax on civil law transactions (TACL)

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

Foreign companies may not benefit from the tax consolidation regime provided under the Polish CIT law. However, certain objections may be raised against such regulations under the EU law principles. On the other hand, the general tax exemption for investment funds is accessible also for foreign investment funds from European Union or European Economic Area (provided that they satisfy the statutory conditions applicable to Polish investment funds). When a foreign company acquires shares in a Polish entity, 1% TACL of the FMV of shares is due (save for certain exemptions) – see more in question 11.

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

Under the Polish CIT law, in kind contributions of a going concern, mergers, divisions, spin-offs and exchanges of shares may be performed free of tax based on the domestic provisions implementing Merger Directive (90/434/EEC). The possibility for tax neutral reorganisation comprises also cross-border mergers of capital companies (including companies limited by shares).

The domestic provisions provide for specific conditions for neutrality of mergers (the operation is CIT neutral provided that the surviving company holds at least 10% of the shares of the company disappearing through the merger, or does not hold any shares in the latter). Spin-offs and divisions are neutral provided that both the assets carved out and staying in the divided company constitute organised parts of an enterprise.

Due to specific anti-abuse regulations, tax neutrality of mergers, spin-offs or exchange of shares only applies provided that business justifications for these operations are assured. Moreover, please note that Polish transfer pricing regulations allow the tax authorities to examine the arm`s length conditions of remunerations in relation to restructuring between related entities (including an exit charge or a lack of it thereof).

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

A number of Polish Double Tax Treaties (DTT) provide for a rule leading to taxation of income realised on alienation of shares in real estate companies in Poland (so called 'real-estate clause' – e.g. DTT with Luxembourg). Also the Polish CIT Law provides for a real estate clause.

Under these provisions, real estate companies should be generally referred to as entities the value of which (or the value of their shares being alienated) is directly or indirectly derived mainly (some treaties provide for 50% ratio) from immovable property.

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

Polish CIT Law allows a group consisting of at least two capital companies linked by capital relationships to be viewed as a single taxpayer for income tax purposes i.e. to create a TCG. The CIT provisions include a number of requirements that have to be fulfilled to establish a TCG, e.g. it should consist solely of the Polish capital companies (only limited liability – sp. s o.o. and / or joint-stock companies – S.A.), it is required that there are at least two companies in a TCG, the average share capital of each company should be at least PLN 500k, at least 75% shareholding required between the company and subsidiaries (two-tier structure).

In general, the main reason behind the establishment of the TCG is a consolidation of tax results of its members. The benefits of TCG is that taxable income of TCG is calculated as an excess of the aggregated income of all members in the TCG over their aggregated losses. Following this, there are other advantages of the TCG such as the lack of application of transfer pricing rules to a transaction between TCG companies.

Additionally, consolidation of the tax result can be also achieved in a structure involving a holding company having shares in partnership(s) running business activity.

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

In Poland there is no special tax status such as a patent box for companies holding intangible assets. However, the Polish government is working on it.

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

Currently there is no any special adverse tax regime in case of a transfer of intangibles outside of Poland although generally subsequent cost of use of intangibles will be limited – based on the new CIT regulations, tax deductibility of payments / amortization write-offs for intangibles previously owned is limited to the value of income generated from its sale. Additionally, transfer pricing / GAAR rules will apply.

# 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?

Polish CIT does not provide for a participation exemption regime in respect to sales of shares, except special provisions for companies investing in R&D companies. Based on this provisions, if so-called commercialized intellectual property (e.g. royalties, patent, know-how) is contributed in-kind by the so-called commercialized entity, the taxable revenue will arise after five years from this moment.

Any profits realised on such transactions are generally subject to 19% CIT (based on tax baskets rule). However in practice, tax effective share deals have been achieved through exchange of shares transactions prior to the sale. It should be however noted that under current anti-abuse rules, share for share exchange transactions are deemed to be conducted to achieve tax benefits (and thus are not tax neutral) if there is no business reason for its performance.

Also the structure which is very frequently used is a sale of shares in a Polish company via a foreign holding company located in a jurisdiction providing for a participation exemption regime and with which Poland has a DTT under which capital gains will be fully taxable at the level of seller (i.e. no real estate clause).Such structures should be business justified and have proper substance, otherwise anti abuse regulations may apply.

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

Polish CIT Law does not contain special incentives for the reinvestment of income. Nevertheless use of closed-end investment funds (FIZ) should allow the postponement of effective taxation of profit until it is paid, which gives the possibility to conduct neutral reinvestments.

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

Under the general rule, the company will be regarded as a tax resident in Poland if it has its seat or place of management in Poland. There are no specific rules or interpretation on how the place of management should be understood, however there is a growing tendency among the tax authorities to examine the substance of international structures of which Polish entities are a part of. To some extent, CFC provisions regarding genuine business activity requirements can serve as a point of reference. Additionally, in June 2017 the Ministry of Finance published a document describing when a foreign holding structure may be treated as  an aggressive optimization and where it listed a circumstances proving that the foreign holding (SPV) does not have a place of management in its jurisdiction which are among others: (i) directors of SPV are at the same time management board members of the Polish company, (ii) directors  of SPV reside and perform their duties in Poland and their visits in the country of SPV is limited only to sign documents or take resolutions, (iii) there are no specific tasks assigned to these directors, (iv) directors of SPV do not have a special competence and knowledge to perform their duties, (v) there is no documentation proving performance of their duties, (vi) there is no office of the SPV, e-mails, telephone numbers, (vii) the SPV does not have employees (besides administration). It may be expected that the tax authorities when analysing the residency of the holding companies will take into account also the above conditions.

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

Under certain circumstances, mergers may be performed free of tax, provided that the restructuring has business justification and is not only tax driven (see question 15). Tax neutrality of spin-offs can be assured if both the carved out part of the company and the part of business that remains in the demerged company constitute an organised part of an enterprise (OPE).

In case the transaction does not involve OPEs, a demerger may be subject to taxation in Poland on the surplus of the emission value of shares (which is a price for the taken up shares not lower than their market value) acquired by shareholders in the new entity over the value or amount of expenses incurred in order to take over or acquire shares in the divided company, calculated proportionally to the ratio of the nominal value of that shareholder's shares in the divided company to the nominal value of shares before division. Mergers and spin-offs are generally VAT-neutral.

## MANAGEMENT INCENTIVES

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

There are no specific tax considerations in Poland for management incentives. As a rule, management activities are subject to personal income tax, at an applicable progressive tax rate of 18 % to 32 %.

However, within new provisions (which are in force as of 1 January 2018) income of employee who actually acquire shares of their employee or its dominant entity (within the meaning provided in the Polish Accounting Act), as a result of execution of the incentive program, is subject to taxation not earlier than upon sale of these shares (even if the shares are acquired free of charge or for price lower than FMV of the shares). Sale of shares will be subject to 19% flat rate taxation.

**Deferral conditions are as follows:**

- the employee incentive plan needs to be implemented by joint-stock company or its dominant entity (within the meaning provided in the Polish Accounting Act) based on the resolution of general meeting of shareholders
- the entitled individual acquires shares of the employer or its dominant entity
- individuals (employees or co-workers who receive income from civil law contract) who acquire shares either directly or through execution of rights resulting from securities
- the emitent's registered office should be localised on the territory of the country with which Poland has concluded a double tax treaty. This provision should be changed since under its literal meaning the tax deferral would not be applicable towards shares in Polish companies

In case when deferral conditions are not met, income derived from realisation of specific securities and financial derivates should be recognised as income derived under basic contract (i.e. income from employment contract or income from other sources). In both cases income would be subject to progressive taxation (18% or 32% rate PIT). Income from employment contract will be also subject to social security and health insurance contributions.

**The Polish tax law does not regulate directly the moment of the taxation In this regard, thus the following be considered:**

**1)** If the shares are acquired free of charge or for price lower than FMV of the shares tax obligation will arise at the moment of grant of the said benefit. Value of granted instrument will be subject to progressive taxation and social security and health insurance contributions (as employment income), or

**2)** Upon sale of shares - the taxable base will be the excess (recognised as capital gain) as difference between price resulting from sale and value of granted financial instruments and subject to flat tax rate 19%.

Additionally, for individuals who conduct management and advisory services there are also certain mechanisms allowing for the application of 19% flat rate taxation of advisory activities.

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# PORTUGAL

# PORTUGAL

## INTERNATIONAL DEVELOPMENTS

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

The Portuguese Corporate Income Tax (CIT) Code was subject to a reform in 2014 which revamped the rules dealing with M&A deals. For that reason, only minor changes have been introduced in the last couple of years. Find below an outline of the main changes introduced recently:

- The application of the Portuguese participation exemption regime now requires the uninterrupted maintenance of a 10% shareholding for 1 year in the capital of another company;
- A new anti-hybrid mismatches clause has been introduced in order to deny the application of the participation exemption to inbound dividends which gave rise to a deduction at the level of the distributing company;
- A new sectorial anti-abuse provision was introduced to deny the application of the participation exemption regime to inbound and outbound dividends whenever there is an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage, defeat the object and the purpose of elimination of double taxation;
- Tax losses arising as from 2016 may be set-off against 70% of the profits and carried-forward for a period of 5 years (previously the period for carry-forward was 12 years);
- A new tax deferral mechanism was included in the exit tax provision. The new options for the deferral of payment of tax are in accordance with the case-law of the ECJ and provide for the option of: (i) immediate payment of CIT upon exit; (ii) option for payment in five instalments; and (iii) option for deferral until the year of effective disposal of the asset or transfer of residence to another (non-EU) jurisdiction
- The 2018 State Budget introduced a new rule deeming as Portuguese sourced the income deriving from the indirect transfer of immovable property located in Portugal – namely via the transfer of shares of foreign companies, if, at any time during the 365 days preceding the alienation, more than 50 percent of the value of the shares is derived, directly or indirectly through one or more interposed entities, from immovable property located in Portugal. This rule does not apply to properties assigned to agricultural, industrial or commercial activities not related to property trading.

### 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 DIRECTIVE?

Portuguese Authorities have not been in the forefront of BEPS implementation at this stage, although they have approved a number of direct tax measures recommended by the BEPS Action Plans or imposed by the PSD and ATAD. There is no official position or guidance from the Tax Authorities on how Portugal will implement the measures recommended by BEPS Action Plan 6, in particular in the context of the Multilateral Instrument.

Portugal has signed the Multilateral Instrument (MLI) but has not yet initiated the legislative procedures to ratify the MLI. The Covered Tax Agreements under the MLI are 79 tax treaties. Portugal has published a provisional list of expected Reservations and Notifications. The main reservations include: (i) Opt out of Article 3 (Transparent Entities), Article 4 (Dual Resident Entities), Article 10 (PEs in Third Jurisdictions), Article 12 (Commissionnaire Arrangements) and Article 14 (Splitting-up of Contracts); (ii) Adopted the Principal Purpose Test (Article 7); (ii) Opted in for Article 9 (Capital Gains), Article 13 (PEs Specific Activity Exemptions) and Article 19 (Mandatory Binding Arbitration) with reservations to the scope of items subject to Arbitration.

Portugal had already enacted measures mirroring the majority of those included in the Anti-Tax Avoidance Directive (ATAD), as outlined below:

- **Controlled Foreign Corporation (CFC) rule:** Portuguese CFC rules foresee that a company resident in Portugal, holding directly or indirectly shares in a qualifying CFC, is subject to tax on the profits realized by that CFC even if no dividend distribution occurs. For Portuguese tax purposes, a CFC is an entity held by Portuguese residents (25 per cent shareholding or 10 per cent where more than 50 per cent of the capital is held by Portuguese residents) which is located in a low-tax jurisdiction (i.e. blacklisted territories and jurisdictions imposing no CIT or where CIT liability does not exceed 60 per cent of the Portuguese CIT standard rate – 12.6%);
- **General Anti-Abuse Rule (GAAR):** The Portuguese GAAR provides that a particular transaction may be disregarded for tax purposes whenever a transaction (or set of transactions) involves: (i) the creation of wholly artificial arrangements; (ii) with abuse of legal forms; (iii) in order to reduce, eliminate, or defer the tax normally due or to obtain undue tax advantages;
- I**nterest barrier rule:** since 2013, Portugal replaced its former current thin-capitalization rules by an interest barrier rule which limits the deductibility of net financial expenses to the higher of the following: (i) Euro 1 million; or (ii) 30% of adjusted EBITDA (operating profits before interests, taxes, depreciations and amortizations). The Portuguese regime includes specific rules for thresholds to be calculated at the level of entities taxed as part of a tax group;
- **Exit tax:** The Portuguese CIT Code provides for an exit tax upon the transfer of residence of Portuguese companies to other territories. Whenever the company transfers its residence to other EU/EEA countries, besides the possibility of immediate payment of CIT upon exit, the exit tax rules provide for an option for payment in five instalments and an option for deferral until the year of effective disposal of the asset or transfer of residence to another (non-EU) jurisdiction. The application of options for deferral imply the accrual of interest on an yearly basis over the amount of tax that would be due and the migrating company would be required to provide a bank guarantee covering the 125% of the tax due (in order to cover tax and interest accruing annually);
- **Switchover clause:** the domestic participation exemption applicable to inbound dividends (from the EU, EEA or third countries) does not apply to distributions of profits which gave rise to a deduction at the level of the distributing company

In addition to these measures, Portugal has also implemented in its domestic law the anti-hybrid mismatches clause and the new sectorial anti-abuse provision recently introduced by the PSD. Portugal also has adopted since 2009 mandatory disclosure scheme for aggressive or abusive transactions, arrangements, or structures.

## GENERAL

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

**A) Acquisition of shares (Share deal)**

Under a share deal, any potential or effective tax contingencies or liabilities will remain at the level of the entity whose shares are being transferred (target entity). The value for tax purposes of the assets owned by the target entity is not subject to a step-up in value and tax attributes (such as tax losses, tax credits or tax benefits) will be generally carried over.

The Portuguese CIT Code provides that tax losses generated in tax years starting on or after 1 January 2016 can be carried forward for 5 years (capped at 70% of the taxable income of the entity generating income). However, this rule does not have retroactive effects and the tax losses of prior financial years shall be carried-forward

for the number of years that were allowed under the CIT Code at the time they were registered (6 years carry-forward for losses computed before 2010, 4 years if the losses were computed in 2010 or 2011, 5 years if the losses were computed in 2012 or 2013 and 12 years if the losses were computed in 2014 and 2015).

In addition, the Portuguese CIT Code includes a set of anti-trafficking rules according to which tax losses carried forward will be forfeited upon a change in direct ownership of at least 50% of shareholding or voting rights. Specific safe-harbors are included for purposes of change of this ownership test covering for example: (i) internal reorganizations whereby shareholding of the company is changed from direct to indirect ownership or from direct to indirect or (ii) reorganizations undertaken under the tax neutrality regime. Outside the safe-harbors, a specific request is required to preserve the tax losses.

Share deals generally do not give rise to VAT, Stamp Tax or Real Estate Transfer Tax (RETT) at the level of the purchaser. However, the acquisition of quotas of a limited company - Lda type (not qualifying as a corporation or S.A.) - that owns immovable property is liable to the payment of RETT at a 6.5% rate when, by such acquisition, one of the shareholders becomes the owner of a participation of at least 75% of the equity of the company (applicable on the property tax value or balance sheet value if higher).

The shares being transferred will benefit from a step-up in value for tax purposes at the level of the purchaser.

The sale of shares may give rise to capital gains or losses at the level of the seller. For more details on this aspect, please see Section 20 below.

**B) Asset deal**

Asset deals usually allow for greater simplicity for the seller and purchaser, since there is no need of pre-structuring of the transaction.

Any historical tax contingencies or liabilities will not be transferred to the purchaser of the asset (although some exceptions may be found in property taxes). Tax attributes (such as tax losses, tax credits or tax benefits) linked to the activity carried on by the seller with recourse to a certain asset may not be carried over to the purchaser. The value for tax purposes of the assets transferred will benefit from a step-up in value at the level of the purchaser.

Capital gains derived from the sale of assets may benefit in some cases from a reinvestment relief, according to which 50% of the capital gains derived from disposals of tangible fixed assets and intangible assets held for more than one year may be exempt if the sales proceeds are invested in similar assets during the period beginning one year before the year of the disposal and ending two years after the year of the disposal. This rule does not apply to investment properties.

From a VAT perspective the acquisition of a business as a going concern susceptible of forming an independent branch of activity (including the assets, liabilities and commercial relations of seller) is not subject to VAT, if the purchaser is liable or becomes liable by virtue of the transaction, to this tax. The transfer of single asset(s) is subject to VAT at the standard 23% rate.

If the transfer is not subject to VAT, an assessment must be made as to whether or not stamp tax should be levied on the transaction. For stamp tax purposes reference should be made to trespasse (transfer of a business) which is liable to Portuguese stamp tax at 5% on its value. The purchaser must pay stamp tax. There is an ongoing discussion on whether the taxable base should be the purchase price or the goodwill (with recently unpublished rulings favoring the latter).

The purchase of real estate located in Portuguese territory triggers RETT and Stamp Tax on the acquisition value or the property tax value, whichever is higher, at rates of up to 6.5% percent for RETT (depending on the nature of the building) and 0.8% for Stamp Tax. Both taxes are borne by the acquirer and should be paid before registering the public deed of acquisition. Careful planning is required for acquisition of real estate property under the special regime of waiver of the VAT exemption. If real estate is transferred in the framework of a going concern, RETT is due regardless of the potential VAT treatment.

## 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?

The Portuguese CIT Code does not include any specific provisions which provide for a step-up in value of the assets of the target company.

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

The acquisition cost of certain intangible assets (such as goodwill) with unlimited-life may be CIT deductible at a 5% rate over 20 years. This rule applies only to goodwill acquired in a (non-tax neutral) business combination registered or purchased as of 1 January 2014. Portuguese tax law does not provide for a definition of 'business combination'. In any case, the interpretation of the concept of 'business combination' should be consistent with the definitions set out in IFRS 3. Any goodwill registered with such transaction (which would be subject to Stamp Tax to the extent the assets transferred qualified as a transfer of a going concern for Portuguese tax purposes) would be deductible for CIT purposes. Should no goodwill arise from the transaction, no CIT deductibility would be available (but simultaneously there would be no stamp tax implications).

### 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?

Interest expenses are tax deductible according to an accrual basis, provided they are required to be incurred or borne to "obtain or ensure" the receipt of income liable to CIT. Deductibility of interest expenses is therefore subject to a "correlation test" according to which expenses should only be deductible to the extent they can be considered linked to the income liable to tax, i.e., that they were incurred to obtain or ensure the receipt of income liable to tax.

In addition to the general deductibility test for expenses, interest barrier rules will apply irrespective of the debt being intra-group or external financing. According to the Portuguese interest barrier rules, the deductibility of net financing expenses (i.e. difference between interest paid and interest received) will be limited to the higher of the following: (i) € 1 million; or (ii) 30% of adjusted EBITDA. Interest in excess or unused interest (up to the EBIDTA threshold) of the limit may be carried forward for 5 years. The concept of "net financing expenses" does not encompass financial expenses which were capitalized as acquisition cost of a certain asset (as these will be amortized or depreciated throughout the useful life of the asset).

For intra-group financing, interest expenses will only be deductible to the extent that they are arm's length. Whenever transfer pricing rules do not apply, interest expenses paid in the context of shareholder financing are only tax deductible to the extent the interest rate applied does not exceed a rate determined by ministerial order.

The Portuguese CIT Code does not have any specific anti-abuse rules dealing with the deductibility of interest expenses borne for the acquisition of a group company. General anti-abuse rule may play a role subject to a case-by-case analysis.

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

For Portuguese tax purposes, debt-push down strategies generally require foreign investors to structure the acquisition of a local target company through a Portuguese local vehicle (HoldCo). The Portuguese HoldCo and local target company may be taxed under the tax group regime and therefore interest paid by the HoldCo would be off settable against the target company's profits. Another alternative would be to merge the Portuguese HoldCo and the local target company. Debt push-down structures will only be tax efficient to the extent the

amount of interest paid does not exceed the thresholds set out by Portuguese interest barrier rules and that the financing arrangements are compliant with transfer pricing rules. In addition, the application of the General Anti-Abuse Rule may also need to be considered on a case-by-case basis. In reverse mergers, tax authorities have questioned transactions either based on the indispensability of the financing (under the old rules) or by considering that the transaction was implemented principally for tax motives, i.e. absent of valid economic reasons.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Portuguese tax law provides for a notional interest deduction on subscribed share capital contributions with limited scope. The notional interest deduction corresponds to a CIT deductible deemed interest expense in the year of the capital contribution and the following five fiscal years computed through the application of a 7% rate over the share capital contribution not exceeding € 2 million. The notional interest deduction applies to share capital contributions subscribed in cash or through the conversion of shareholder loans (granted in cash) into share capital and also within the context of a conversion of credits carried out within a share capital increase (thus no longer being restricted to shareholders). Contributions in kind to the capital of the company do not qualify for the purposes of the notional deduction. In case the company reduces its share capital within the five year period the notional deduction is recaptured (added to taxable profits) and increased by 15%. The application of the notional interest deduction implies a reduction of the second threshold of the Portuguese interest barrier rule, from 30% to 25% of the adjusted EBITDA.

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

Portuguese anti-loss trafficking rules only deal specifically with direct acquisitions of shares. Tax losses carried forward will be forfeited upon a change in direct ownership of at least 50% of shareholding or voting rights. Currently there are no rules dealing with tax losses forfeit due to changes on the activity. The following safe-harbors were included for purposes of change of this ownership test:

- internal reorganizations whereby shareholding of the company is changed from direct to indirect ownership or from direct to indirect;
- reorganizations undertaken under the tax neutrality regime;
- changes due to succession upon death of the former shareholder;
- prior ownership by the purchaser of at least 20% of shareholding or voting rights of the company since the taxable period in which the tax losses were registered; and
- the purchaser is an employee or a member of the company's bodies since the taxable period in which the tax losses were registered

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

Any specific items which should be included in the scope of a tax due diligence will be directly linked to the nature of the transaction (asset deal vs share deal), the business carried on by the target or any specific tax attributes or benefits associated with the target company or assets. In any case, the following items can be identified as being generally relevant in all due diligences:

- Statute of limitation: Portuguese tax law provides different statutes of limitation and therefore contingencies identified in the same FY may have different statutes of limitation;
- Tax losses: Due to several changes in the period for tax losses carryover (see Section 3 above), a tax due diligence should identify with detail the year in which tax losses were registered and the year in which they will forfeit;

- Group taxation applicable to the Target: Since all entities part of a Portuguese tax group are jointly responsible for the payment of corporate taxes, it is relevant to cover this aspect if the Target was or is integrated in a tax group
- Real Estate: In case of real estate property owned by the Target it is important to review the VAT nature of (previous) purchases – if under the waiver of VAT exemption regime and whether the certificates of waiver were obtained

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

In most instances there is none. In any case, Real Estate Transfer Tax (RETT) may apply on the acquisition of quotas of a limited company - Lda type (not qualifying as a corporation or S.A.) - that owns immovable property in Portugal. The purchaser would be liable to the payment of Real Estate Transfer Tax at a 6.5% rate when, by such acquisition, one of the shareholders becomes the owner of a participation of at least 75% of the equity of the company (applicable on the property tax value or balance sheet value if higher). No other indirect taxes (such as VAT, Stamp Tax, Municipal Property Tax or other charges or fees) are due on the transfer of shares.

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

As a general rule, expenses incurred or borne are deductible for CIT purposes to the extent they had the purpose of obtaining or ensuring the receipt of taxable income. According to this “correlation test”, acquisition costs should only be deductible to the extent they can be considered linked to the income liable to tax, i.e., that they were incurred to obtain or ensure the receipt of income liable to tax. The acquisition cost of shares is not immediately deductible as an expense for CIT purposes but will be taken into consideration for the computation of capital gains or losses upon sale. Acquisition costs with the majority tangible and intangible assets are generally amortized / depreciated and therefore deductibility will occur on a pro rata basis taking into consideration the useful lifetime of those assets. The acquisition cost of certain intangible assets (such as goodwill) with unlimited-life may be CIT deductible at a 5% rate over 20 years.

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

As a matter of principle, based on ECJ and Local Arbitration case law, input VAT on acquisition costs may be recoverable if the holding company (Portuguese acquisition vehicle) in a share deal provides services subject to VAT to its subsidiaries. The VAT regime applicable to holding companies remains contentious in Portugal and ultimately depends on whether such holding companies carry out transactions which are subject to VAT, such as the provision of administrative, financial, commercial and technical services by the holding company for the benefit of its subsidiaries. For asset deals, VAT paid on the value of the single assets (when not excluded as a transfer of going concern) is recoverable under the generally applicable rules. It is important at early stage of any M&A transaction to review the cost structure and the VAT and CIT treatment. Recovery of VAT on real estate transactions depends on the transaction being either framed under the waiver of VAT exemption regime or the leases being service agreements or shop rental agreements subject to VAT.

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

The acquisition tax structuring should take into account, amongst others, the following aspects:

- **Distribution of dividends** –Domestic withholding tax exemption whenever the following requirements are met: (i) 10% of the share capital or voting rights of the Portuguese company held for at least 1 year prior to distribution; (ii) available for shareholders resident in EU/EEA Member-States (excluding states with no exchange tax information) or any jurisdiction which has signed a tax treaty with exchange of information

mechanism; and (iii) company receiving the dividends (if third country) should be liable to nominal rate of 60% of the Portuguese rate (i.e. 12.6%). In case exemption is not applicable, lower rates may still apply under a tax treaty in place. 35% withholding applies to blacklisted jurisdictions

- **Financing** – Outbound interest is subject to a 25% flat rate. A domestic withholding tax exemption is available for creditors qualifying as an associated company (i.e. a company holding a direct participation of at least 25% for a period of, at least, two consecutive years) for purposes of the Interest and Royalty Directive. Otherwise, a reduced withholding tax rate may be applicable under a tax treaty in place; 35% withholding applies to blacklisted jurisdictions
- **Divestment** – Capital gains derived by non-residents are subject to a flat 25% rate. However, capital gains derived by non-resident entities without a permanent establishment in Portugal may benefit from an exemption provided certain conditions are met (see Section 20 below)
- **Other considerations** – (i) economic rationale – since Portuguese tax law has Specific and General Anti-Abuse provisions, the tax authorities may disregard the application of domestic exemptions based on the lack of economic substance; (ii) residence of the foreign investor – investors resident in blacklisted jurisdictions are subject to a more burdensome tax treatment.

Special considerations may arise when transactions involve the use of companies subject to the Madeira International Business Center regime. The Madeira IBC special tax regime has been authorized by the European Commission as legal regional State Aid. It offers companies incorporated therein or companies that will be incorporated until December 2020, as well as to their shareholders, several tax benefits until December 2027. Insofar as certain economic substance requirements are met, these corporations may enjoy a 5% corporate income tax rate, among other benefits to be assessed on a case by case basis. In order to be entitled to the tax benefits above stated, companies registered under the MIBC regime shall meet one of the following requirements: (i) Creation of one to five jobs in the first six months of activity, and an investment of minimum € 75,000 through the acquisition of fixed, tangible or intangible assets, in the first two years of activity; or (ii) Creation of six or more jobs in the first six months of activity. Those IBC entities are subject to a cap on the tax benefits granted, determined according to the number of jobs created.

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

Upon completion of an acquisition, groups may reorganize their corporate structures under the tax neutrality regime for corporate restructurings. The Portuguese tax neutrality regime is the transposition of the EU Merger Directive and provides for a mechanism of deferral of capital gains taxation on mergers, demergers, partial demerger, transfers of assets and exchange of shares to the extent the value for tax purposes of the assets or shares transferred is carried over. The Portuguese regime extends the neutrality regime to a broader set of transactions than that covered by the Merger Directive. In order for a subsidiary to be included in a Portuguese tax group, the parent company must hold the participation for more than one year from the date the regime begins to be applied (except when the subsidiary is newly incorporated). For this reason, newly acquired target companies may only be included in a tax group one year after acquisition. A period of two years is required in case the company registered tax losses.

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

Share deals generally do not attract Real Estate Transfer Tax (RETT) at the level of the purchaser. However, the acquisition of quotas of a limited company – Lda type (not qualifying as a corporation or S.A.) - that owns immovable property located in Portugal is liable to the payment of RETT at a 6.5% rate when, by such acquisition, one of the shareholders becomes the owner of a participation of at least 75% of the equity of the company (applicable on the property tax value or balance sheet value if higher).

Companies owning real estate will also be liable to Municipal Real Estate Tax (IMI), which is a real estate tax levied annually on property located within each municipality. The IMI rates range from 0.3% to 0.8% over the property tax value. However, whenever the properties are owned by entities resident in blacklisted jurisdictions a 7.5% rate will apply. The Budget Law for 2017 introduced an additional 0.4% IMI charge for companies on the right of ownership, usufruct or surface over real estate property located in Portugal (urban property classified as «commercial, industrial or for services» fall outside the scope of this additional charge). The property tax value of real estate property may be subject to revaluation by the Portuguese Tax Authorities, which may result in increased tax costs in the future at the level of the target company.

The VAT framework applicable to the acquisition of the real estate properties by the target company may also be relevant. The acquisition of real estate is generally exempt from VAT, unless the vendor waives the right to exemption (which would allow the purchaser to deduct the input VAT). The option for taxation is only possible for real estate complying with certain requirements and provided both vendor/lessor are Portuguese VATaxable persons and fulfill, among others, the condition of conducting supplies that give the right to VAT deduction. Prior assessment of whether these requirements were complied with may also be relevant.

Ownership of real estate assets in Portugal may also lead to the non-application of the domestic exemption on capital gains derived by resident or non-resident investors.

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

The Portuguese CIT Code provides for tax group regime which is an elective regime for the combination of tax liabilities of group of companies. The tax group regime is applicable whenever the parent company holds, directly or indirectly, at least 75% of the subsidiaries' share capital and 50% of voting rights for more than one year (except when the subsidiary is newly incorporated). The Portuguese tax group operates under a "pooling system" where the tax group itself has no fiscal personality, i.e. the parent company and its subsidiaries remain autonomous taxpayers for tax purposes. The individual tax results of group members are aggregated and therefore losses derived by one of the group entities (after being integrated in the group's perimeter) may be offset against the profits of other group entities. Tax losses derived prior to integration in the group may only be off-set against the profits of that same entity (and not directly against profits derived by other group entities). The Portuguese tax group regime does not eliminate intra-group transactions and thus transfer pricing rules are still applicable.

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

A Patent Box regime was enacted in 2014 and provides for a 50% CIT exemption for companies exploiting or disposing of patented inventions and other innovations such as models and industrial designs protected by IP rights (income from know-how is excluded from the scope of the regime). The 50% exemption applies only to qualifying net royalty income, i.e., income derived after deduction of costs incurred in the development of the qualifying IP. Such non-exempted income is subject to the standard CIT rate plus any applicable Municipal and State Surtaxes (see Section 20).

The Portuguese regime follows the Modified Nexus Approach recommended by OECD Base Erosion Profit Shifting ('BEPS') Action 5 and therefore the regime will apply only to the extent that the taxpayer incurred in eligible research and development ('R&D') expenses connected to that IP. The main requirements to apply the Patent Box are: (i) licensee cannot be resident of a blacklisted jurisdiction; (ii) IP must be effectively used for business activities; (iii) since licensees are related companies, the IP cannot be used to create deductible expenses for the taxpayer; and (iv) financial records which allow the identification of the expenses borne with the R&D activities which are directly attributable to the IP being exploited, as well as the income derived from those IP assets being exploited. The amount of qualifying expenses is increased to 130% for deductibility purposes. The deductible qualifying expenses may not exceed however the amount of total expenses. As Portugal already amended the domestic law to reflect Action 5 of BEPS, no further adjustments are expected.

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

There are no specific adverse tax consequences foreseen in the Portuguese CIT Code for the transfer of ownership of intangibles out of Portugal, and therefore the general rules exit tax should apply. Nevertheless, specific tax incentives or credits may be forfeited, which requires a case-by-case analysis.

## 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?

For Portuguese CIT purposes, capital gains derived by Portuguese companies are included within the taxable profits generally subject to the standard 21% CIT rate, plus a municipal surtax ('derrama municipal') up to 1.5% on taxable profits (depending on the municipality), as well as a state surtax ('derrama estadual') of 3% on taxable profits exceeding €1,500,000, 5% on taxable profits exceeding € 7,500,000 and 9% on taxable profits exceeding €35,000,000. A special reduced CIT rate is available for SME.

Under the participation regime, a Portuguese company deriving capital gains from the sale of shares or quotas may benefit from an exemption provided the following requirements are met:

- **(i)** 10% of the share capital or voting rights of the company whose shares are being sold;
- **(ii)** 1 year holding period prior to sale;
- **(iii)** Company whose shares are being sold should be subject either to CIT, taxes listed in the Parent Subsidiary Directive or if resident outside the EU/EEA a tax comparable to the Portuguese CIT at a nominal rate, corresponding to at least 60% of the Portuguese rate (i.e. 12.6%).

The participation exemption regime does not apply whenever the assets of the company whose participation is disposed consist of more than 50% of Portuguese real estate (except for properties assigned to an agricultural, industrial or commercial activities not related to leasing and property trading or property acquired before 1 January 2014).

Differently, capital gains derived by non-resident shareholders are subject to a flat 25% rate. Although the participation exemption regime does not apply in this situation, the law provides a domestic exemption if capital gains are derived by non-resident entities without a permanent establishment in Portugal and provided that the following conditions are met:

- **(i)** the seller is not owned, directly or indirectly in more than 25% by a Portuguese resident company/individual;
- **(ii)** the seller is not resident in a blacklisted jurisdiction; and
- **(iii)** the gains derived do not relate to shares or corporate rights in resident companies whose assets consist in more than 50% of Portuguese-situs immovable property or holding companies, when such companies are in a control relationship with resident companies whose assets consist in more than 50% of Portuguese-situs immovable property.

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

The reinvestment regime provided by the Portuguese Code does not apply to the sale of shares or investment properties (i.e. real estate). Under this regime, 50% of the positive difference between capital gains and capital

losses can be excluded from taxation to the extent that the total amount of the sale's proceeds is reinvested in the year prior to the disposal or before the end of the second following year (i.e. N-1, N, N+1 and N+2) in the acquisition, manufacture or construction of tangible fixed assets or non-consumable biological assets and used for the activity of the acquiring company (i.e. only assets and not shares). In order for the reinvestment regime to apply, the assets in which the proceeds are reinvested: (i) may not have been acquired from a related party for transfer pricing purposes; and (ii) must be held for a one year period.

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

Portuguese tax law does not require any specific substance requirements for holding companies (such as minimum number of employees, turnover, etc.). Notwithstanding, Portuguese CIT Code includes a set of anti-abuse provisions which deny the application of the participation exemption regime to inbound and outbound dividends whenever there is an arrangement or a series of arrangements which have been put into place for the purpose of obtaining a tax advantage that defeats the object and the purpose of elimination of double taxation, i.e., whenever the arrangement does not have valid commercial reasons and lacks economic substance. Furthermore, Portuguese tax law provides for a General Anti-Abuse Rule which allows the Portuguese Tax Authorities to deny a tax benefit if a certain structure is tax driven. Against this background, it is clear that holding companies must comply with a certain level of substance, namely the financial, material and human resourced necessary for the carrying on of its activity within the context of the group.

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

As outlined above, generally the restructuring should be analyzed if it may be structured within the Portuguese tax neutrality regime, which is the transposition of the EU Merger Directive deferral mechanism for mergers, demergers, partial demerger, transfers of assets and exchange of shares.

In addition to potential CIT implications, mergers and spin-offs may also give rise to indirect taxation liability.

No VAT or sales tax applies to a merger transaction. The VAT Code expressly excludes from the scope of the tax, the transfer, whether or not for consideration, of a commercial establishment representing all or part of an independent business when the purchaser is or becomes subject to VAT. A transfer of assets which qualifies as "trespasse" (sale as a going concern under Portuguese civil law) may also be subject to Stamp Tax at a 5% rate on the value of the business unit being transferred (tax borne by the acquirer).

The transfer of real estate located in Portuguese territory through a merger or a spin-off also triggers Real Estate Transfer Tax (RETT) and Stamp Tax on the acquisition value or the property tax value, whichever is higher, at rates of 6.5% percent for RETT and 0.8 percent for Stamp Tax for commercial buildings (lower rates for residential buildings up to 6%). A special tax incentive allows companies involved in a merger to qualify for exemption from IMT with respect to the transfer of real estate, as well as exemption from registration fees and stamp tax that normally would be due.

## MANAGEMENT INCENTIVES

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

Portuguese tax law does not include specific management incentives. The only exception to this may be a flat reduced rate applicable under the Non-Habitual Resident (NHR) regime. The Portuguese NHR taxation regime was introduced in 2009 and provides certain special tax rates and rules applicable to individuals that qualify as NHR. Among the benefits granted under this regime, Portuguese sourced income derived by NHR from high added value activities deemed to fall either under employment or business and professional income is taxed at 20% flat rate (applicable only after the Portuguese Tax Authorities' decision). The list of professions and activities that qualify as "high added-value" for purposes of the NHR regime includes senior management. The concept of "top management" for the purposes of the NHR regime is defined as those persons in a management position with a specific power to bind the corporate entity. Therefore, assuming that the applicant is in a management position and has the power (even if limited) to bind the entity, the functions performed may qualify as "high added-value" and therefore benefit from the flat 20% rate. Board members are excluded from benefiting from the regime.

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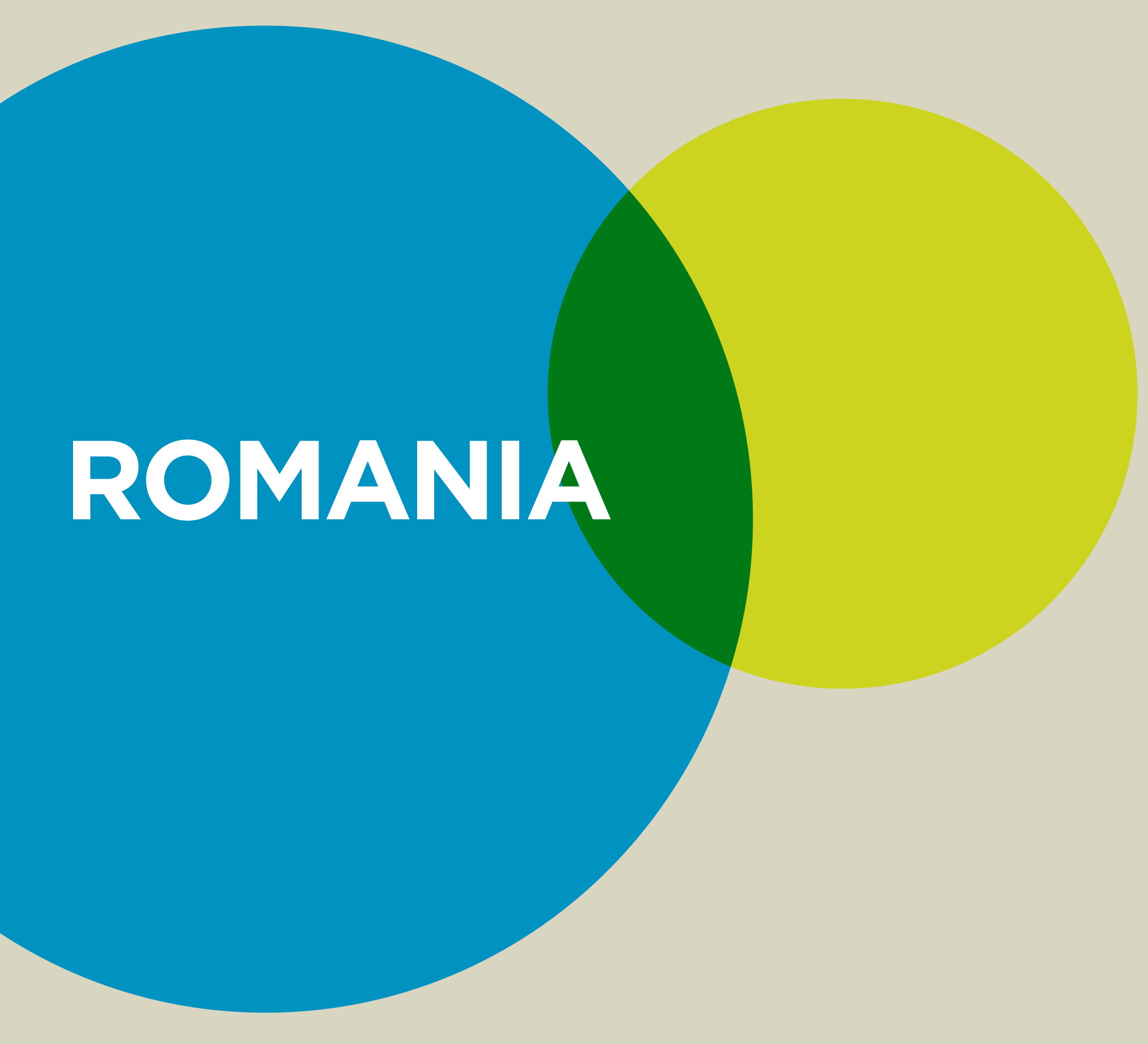

# ROMANIA

# ROMANIA

## INTERNATIONAL DEVELOPMENTS

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

The new Romanian Fiscal Code, in force starting 1 January 2016, brought several amendments to existing tax rules, some of them being relevant also for mergers and acquisitions (M&A). Specifically, stricter conditions apply in order for a partial spin-off to qualify as neutral for direct tax purposes, while from a VAT point of view it is provided that mergers and spin-offs are by default outside the VAT scope (with no additional condition to be met, as it was the case up to 31 December 2015).

The new Code also changed some of the rules relevant for private equity investments, of which we mention the decrease of the dividend tax rate from 16% (in force up to 31 December 2015) to 5% and the introduction of more detailed rules applicable for investment income derived by individuals (e.g. detailed computation methods of gains obtained from transfers of equities and of various types of securities). Moreover, starting 2017, the standard personal income tax rate decreased from 16% to 10%. This applies inter-alia for instance to capital gains derived by resident and non-resident individuals from sale of securities.

### 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?

In June 2017, the Romanian Parliament issued a law which approved Romania's joining the BEPS Project as associate, which allows Romania's participation in the implementation of measures against tax base erosion and profit shifting, as well as their domestic implementation.

It is expected that Romania would implement the four minimum BEPS standards (which include Action 6). Also, on the 7 June 2017 Romania signed in Paris the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting – Multilateral Instrument (Action 15).

Additionally, Romania transposed four rules of Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD) into its domestic legislation starting the 1 January 2018. Those rules are: Interest limitation rule, Exit taxation, General anti-abuse rule and Controlled foreign company rule.

Moreover, Romania transposed in its domestic tax law the amendments brought by EU Directives 2014/86 and 2015/121 to EU Parent-Subsidiary Directive on (i) refraining from taxing the profits received by the Romanian parent company only to the extent they are not deductible for the subsidiary and (ii) regarding the fact that the exemption shall not be granted in case of an arrangement or series of arrangements which are not genuine and have the main purpose or one of the main purposes that of obtaining tax advantage.

## GENERAL

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

**A) Share deal**

**Tax advantages:**

Under a share deal, the target company is entitled to continue with the same tax depreciation plan applicable for its non-current assets as before the transaction.

Sale of shares is a VAT exempt without credit operation.

No real estate tax implications arise in the case of a share deal, as far as the assets of the target are concerned. However, potential notary fees may be due if the parties opt to have the share purchase agreement authenticated by a notary public. In this case, the notary fees are due by either the seller or by the buyer, as contractually agreed between the parties.

The target is entitled to carry forward and recover its fiscal losses in the next 7 consecutive years based on FIFO method provided it is a corporate income tax (CIT) payer. A different taxation system should however be applied by the target for activities carried out in certain fields (e.g. hotel/ accommodation facilities, restaurants/ catering and bars) – if this is the case, the tax due is not determined with reference to profits or income derived, but with reference to certain indicators like the serving area, rank of the city, accommodation capacity etc. - hence, tax losses are not relevant for determining the tax due for these activities. Regardless of the above tax regimes, special tax rules apply in case the target qualifies as payer of tax on micro-enterprises income. The target should apply the tax on micro-enterprises income (3% tax on qualifying income, or 1% tax if it has at least one full time employee) if certain criteria are cumulatively met at 31 December prior to the reporting year. One of the criteria is that the target obtains yearly qualifying revenues not exceeding € 1,000,000. However, starting the 1 April 2018 taxpayers which are obliged to apply the micro-enterprises income taxation may nevertheless opt to apply the CIT system on the condition that their share capital is of at least RON 45,000 (some EUR 10,000) and they have at least two full time employees. The comments in this material take into account a standard CIT payer and hence, they may not be necessarily applicable in case the Romanian company applies other tax regime than CIT (e.g. tax on micro-enterprises income). A case-by-case analysis is therefore required.

The buyer should implement a flexible structure to obtain efficient flows of dividends, borrowings, interest payments, royalties, and management services, while also considering implications for a future exit.

**Tax disadvantages:**

Under a share deal in Romania the buyer takes over all liabilities, including tax liabilities, of the seller with respect to the target. Therefore, buyers should perform in-depth due diligence to quantify the potential risks and seek protection through the sale-purchase agreement (by asking the seller for guarantees and indemnities in respect of pre-closing events).

The tax value of the shares is the acquisition price due by the buyer. The tax value of the shares is used to determine the capital gains tax owed by the buyer in the case of a future taxable share deal, if the specific exemption does not apply.

**B) Asset deal**

**Tax advantages:**

In an asset deal the buyer does not take over the seller's pre-closing financial and tax liabilities as it is the case under a share deal.

For Romanian tax purposes, the useful life of depreciable non-current assets is established within specific ranges, depending on the category of assets concerned. The taxpayer has the option to choose any period falling within the legal range.

Under an asset deal, the buyer is entitled to recover the acquisition price of the depreciable non-current assets during their remaining useful life via tax depreciation charges. The applicable VAT rate depends on the nature of assets transferred (however, VAT is not due if the operation qualifies as a transfer of a going concern). In 2018, the standard VAT rate is maintained at 19%.

No stamp duties, real estate tax or notary fees are due at the moment of the asset deal. Notary fees are due in case the parties opt to authenticate the contract for the transfer of ownership right. Transfer of the ownership right over land and buildings is generally mandatory to be authenticated by a notary public. The notary fees are owed either by the seller or by the buyer, as mutually agreed.

**Tax disadvantages:**

In case of a business transfer, the purchase price allocation should be made based on a valuation report. No tax depreciation is allowed for any resulting goodwill.

Generally, the input VAT incurred upon acquisition of assets may be asked for reimbursement by the buyer. However such a procedure may prove to be administrative burdensome and lengthy (3 to 6 months or may be even longer depending on the complexity of operations, as it generally entails a tax audit). In case of specific operations, VAT simplification measures apply if the seller and buyer are both registered for VAT purposes in Romania. Examples of operations are sales of constructions and land. The simplification measures provide that the buyer accounts for VAT via reverse charge mechanism without any VAT cash-flow effect to the extent it has full VAT deduction right. If the asset deal qualifies as a transfer of a going concern, it falls outside of the Romanian VAT scope and no VAT should apply.

In an asset deal the target's fiscal loss cannot be used by the buyer, but may be off-set by the target against potential gains arising at the date of the asset deal.

If buildings are transferred, the related real estate tax (building tax) which will be owed by the buyer (as new owner) could differ from the real estate tax that was owed by the seller prior disposal. The buildings are charged with different local tax rates depending on their destination (residential vs. non-residential). If the buyer is a legal entity, the taxable base for the first 3 years will be represented by the acquisition cost. Building's value should be updated based on a valuation report prepared by an authorised valuator at least once in every three years, as otherwise the building tax rate will increase.

The seller of a building owes the building tax for the remaining period of the calendar year in which the asset is sold. The buyer owes build tax starting next year (following the acquisition).

## 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?

The value of the tangible and intangible assets in a share deal cannot be stepped up at the date of the share deal. However at the year-end, the value of the tangible non-current assets can be increased for both accounting and tax purposes further to a revaluation of the respective assets which generates a surplus, provided that the target's accounting policy is to reevaluate its depreciable non-current assets. Nevertheless, the CIT impact of increased tax depreciation corresponding to the revaluation surplus is netted-off by an equal taxable item. Recognition of a step-up in value of intangible assets for accounting and tax purposes is not allowed.

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

Goodwill cannot be depreciated for tax purposes.

For accounting purposes, according to the Romanian accounting regulations approved by Order no. 1802/2014, goodwill usually occurs upon consolidation and represents the difference between the purchase price and the fair value of the net assets acquired by an entity at transaction date. Recognition of goodwill in the standalone financial statements is allowed only if the goodwill arises further to a total or partial transfer of assets and liabilities

(under a sale or a merger). Goodwill can be thus recognized if the transfer is related to the transfer of a business represented by an integrated system of assets and operations managed with the view of obtaining profits.

Goodwill recognized as an asset can be depreciated for accounting purposes, during a maximum 5-year period. However entities may depreciate goodwill systematically over a period not exceeding 10 years, with appropriate disclosure in the notes to the financial statements.

Separately from goodwill, expenses related to the acquisition of patents, copyrights, licenses, trademarks or production marks, rights to explore natural resources and other similar intangibles recognized for accounting purposes, as well as capitalized development expenses, may be amortised for tax purposes based on the straight-line method over the contractual period or over their useful life, as the case. However, intangibles with undetermined useful lives may not be amortized for tax purposes. Expenses related to the acquisition or production of software are to be recovered through straight-line or reducing-balance deductions over a period of 3 years. The amortization for patents may be determined also by using the reducing-balance method or the accelerated method. Expenses related to acquisition of customer contracts recognized as intangibles for accounting purposes are to be amortised over the period of these contracts. Set-up expenses recognized as intangibles for accounting purposes are to be amortised over a maximum 5-year period.

## 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 general the rule, expenses (including interest expenses) are deductible if they are incurred for business purposes.

Interest expenses are non-deductible if they relate to non-taxable income. This may be the case if the debt finances the acquisition of shares which may generate exempt dividend income or exempt capital gains upon disposals of the shares acquired (if the holding conditions are met).

In addition, the deductibility of interest expenses should be analysed also under the new Interest limitation rule transposed on the 1 January 2018 from ATAD. This interest limitation should be applied by taxpayers having associated entities. The relationship with an associated entity is generally characterized by a direct or indirect participation of 25% or more of the share capital/vote rights or the right to receive 25% or more of the entity's profits. The limitation rules do not apply to independent companies (i.e. entities which are not part of a consolidated group for financial accounting purposes, having no associated enterprise and no permanent establishment). Also, the limitation rule does not apply in respect of loans used to finance long term public infrastructure projects.

The limitation rule applies to all borrowing costs (e.g. interest corresponding to all types of debts, including bank loans, other expenses incurred in relation to financing like leasing, capitalized interest, foreign exchange losses etc.). The limitation should apply to the exceeding borrowing costs, defined as borrowing costs less interest income and other equivalent income ("Exceeding borrowing cost"). The Exceeding borrowing cost is deductible up to a fixed threshold of EUR 200,000 (this may be increased in the future), while any remaining Exceeding borrowing cost may be deducted up to 10% (this may be increased in the future) of the tax EBITDA (accounting result – non-taxable income + corporate income tax + Exceeding borrowing costs + fiscal depreciation). The part of Exceeding borrowing cost which remains non-deductible in the reference year based on the above limitation rules, may be carried-forward indefinitely and deducted in the future periods subject to the same deductibility limitations.

Separately, if the interest bearing debt is received from a related party, transfer pricing provisions should also be observed.

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

One way to push-down debt related to the acquisition of a Romanian target company is to use a leveraged buyout structure. Under a leveraged buyout a Romanian special purpose vehicle (SPV) is used to buy the target's shares. Subsequently the SPV and the target are merged and, hence, the debt obtained to acquire the target's shares is presented in the resulting entity's balance sheet. However mergers implemented under a leveraged buyout must have business substance in order to be tax neutral. To our knowledge, so far in practice, the Romanian tax authorities have not challenged leveraged buyouts.

As a general rule, expenses are deductible if they are incurred for business purposes. Nevertheless, expenses related to non-taxable income should be treated as non-deductible. If the sole purpose of the debt is to finance the acquisition of shares in a Romanian company, the income obtained therefrom may be either dividends or income from the sale of shares (at a future potential exit). Dividends received from a Romanian legal entity are deemed non-taxable income for the recipient legal entity (SPV) CIT payer. Also, capital gains derived by a Romanian SPV CIT payer upon disposing of target`s shares is also non-taxable for CIT if at the date of disposal, the selling SPV has maintained a minimum holding percentage of 10% for an uninterrupted period of 1 year. Therefore, interest expenses incurred on the loan obtained to acquire the shares in the target would not be deductible for CIT purposes if the SPV earns non-taxable income. CIT deductibility of interest accrued post-merger may be however achieved in certain circumstances, but subject to the Interest limitation rule transposed form ATAD.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

A law for stimulating the individual investors was enforced in 2015. This law regulates the conditions under which individual investors (so-called Business Angels) can benefit from certain tax incentives if they contribute cash of at least EUR 3,000 and maximum EUR 200,000 to the capital of a Romanian small sized limited liability company. According to the law, Business Angels are exempt under certain specific conditions from the following taxes:

- Income tax on dividends for a period of three years since the capital increase, for the dividends related to the shares received; and
- Income tax on capital gains derived from the transfer of the respective shares, if the transfer takes place after a period of at least three years since the capital increase.

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

The target company's fiscal losses are available to be off-set against its own future taxable profits.

In case of a share deal, if after the transaction the target is absorbed by the buyer, any fiscal losses of the target entity can be off-set against the buyer's taxable profits within the same limits (e.g. 7 years since they arose at the level of absorbed entity etc.).

As for an asset deal, the target's fiscal losses may be off-set only against its future profits and therefore cannot be available directly for the buyer.

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

Examples of tax areas which are heavily scrutinized by the tax authorities at present, regardless of the industry of the taxpayer, are:

- Deductibility of service expenses – to claim CIT deductibility, the target should be able to demonstrate with written evidence that the services acquired have been actually rendered, that they were acquired and used for business purposes as well as the benefits derived by the taxpayer therefrom

- Transfer pricing issues may arise for transactions carried out by the target with related parties – these should be carried out at fair market value (in line with the "arm's length principle"). Lack of a complete transfer pricing file may trigger fines and adjustment of taxable basis for CIT purposes and also for VAT in certain circumstances
- Services acquired by the target form individuals organized as freelancers / limited liability companies etc. may be re-qualified in certain cases as dependent relationships from a tax point of view and hence trigger personal income tax and mandatory social security contributions, similar to salaries. These, as well as late payment charges are imposed to the target

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

There is no indirect tax on transfer of shares (certain commissions/taxes may be due if the shares are traded on the regulated market). Sale of shares is an 'exempt without credit operation' for VAT purposes, and therefore no Romanian VAT should be charged.

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

There are no specific restrictions regarding the deductibility of the acquisition costs of the assets under an asset deal. For instance, acquisition cost of fixed assets may be recovered via tax depreciation charges as long as the buyer uses the assets for business purposes and they generate taxable income.

Acquisition costs incurred in view of a share deal should be entirely non-deductible if the investment generates only non-taxable income (e.g. exempt dividends received or non-taxable capital gains obtained in case of a potential exit based on a participation of more than 10% maintained for at least one year). Else, if the investment generates both taxable (e.g. management fees) and non-taxable income, the part of allocable expense which should be non-deductible is to be determined based on a rationale allocation method or based on the weight of non-taxable income in the total income.

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

Any input VAT incurred by the buyer in case of an asset deal may be deducted in certain conditions if the buyer is a VAT taxable person and provided that the said acquisition is made with the view of carrying out VAT taxable operations or operations exempt from VAT with credit. The intention should be properly documented.

Under a share deal, based on the ECJ jurisprudence, the recoverability of VAT incurred by the buyer on acquisitions of consulting services (e.g. services provided by finance advisory and/or legal firms) depends on the status of the buyer from a VAT perspective. For instance, if the buyer is a mere holding company whose sole purpose is to acquire holdings in the subsidiaries and would not directly or indirectly involve in the management of those subsidiaries, it does not have the status of a taxable person and has no right to deduct the input VAT.

If the services are used by the holding company in order to perform both economic transactions giving rise to a right to deduct VAT and also economic transactions that do not, the deduction is allowed only in respect of the part of VAT which is proportional to the amount relating to the former transactions.

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

If a non-resident company acquires the shares of a Romanian target company, the Romanian tax rules applicable to dividends and capital gains are in principle similar with those applicable to acquisitions made by Romanian companies. For instance, a qualifying EU tax resident investor may benefit from withholding tax (WHT) exemption for dividend income received from the Romanian target (under the specific conditions of the transposed EU Parent-Subsidiary Directive). Also, an investor which is resident in a DTT country could also enjoy CIT exemption

in respect of capital gains derived upon disposal of the shares provided that the seller has maintained a minimum holding of at least 10% in the Romanian investee for an uninterrupted period of at least one year. Other formal requirements should be met for availing of such exemptions.

If the holding conditions are not met upon exit (e.g. the 10% and the 1 year period), the capital gains tax due in Romania may be eliminated under the provisions of the applicable DTT. However, certain DTTs award taxation rights to Romania in case the shares sold by the non-resident derive their value directly or indirectly, mainly from real estate located in Romania. This is to be analysed on a case-by-case basis.

If a non-resident company acquires the assets of a Romanian target and continues to operate the business, it will likely give rise to a permanent establishment in Romania, case in which 16% CIT would be due on the allocable taxable profits.

Income derived by the non-resident investor from Romania (like e.g. dividends, interest, royalties, service fees etc.) may be subject to WHT – standard domestic rate is 16%, save for dividends which are taxed at 5%. The domestic rate may be reduced or eliminated under the provisions of the applicable DTT or the EU Directives provisions, as transposed in the domestic law – documentation requirements apply.

Lack of substance of the foreign investor may lead to non-application of the above-mentioned exemptions / reduced rates under DTTs etc. If the foreign investor has the actual place of effective management in Romania, it becomes a Romanian tax resident and is liable to 16% Romanian CIT on its worldwide income. No detailed guidance is provided on substance rules at present under Romanian law. However, general anti-abuse rules are available (covering also artificial cross-border transactions) and may be used to requalify a transaction as to reflect its economic substance.

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

After an acquisition, the group can reorganise by way of a merger or spin-off. Mergers and spin-offs involving Romanian legal entities, as well as EU qualifying legal entities, are generally tax neutral for the difference between the market value of the assets/liabilities transferred and their tax value (i.e. no VAT and no corporate income tax is due), provided that certain criteria are cumulatively met. In case of local partial spin-offs, the transfer should consist of one or more independent business lines towards one or more existing/new entities, while the company undergoing the spin-off operations should maintain at least one independent business line. Mergers and spin-offs must have business substance to be considered tax neutral. Domestic and EU cross-border merger and spin-off operations may not enjoy tax neutrality if they result in fraud and tax evasion detected according to the law.

The transfer of assets and liabilities is not a taxable transfer if the receiving entity maintains the tax value, tax depreciation method and useful lives of the assets transferred upon the merger or spin-off at the same level as they were prior to the reorganisation process.

No CIT grouping is available in Romania at present. This is applicable only for the Romanian permanent establishments of the same foreign legal entity.

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

Attention should be paid to the DTT concluded between Romania and the country of tax residence of the buyer of the Romanian target whose assets are mainly represented by Romanian real estate.

Specifically, it should be checked whether, according to the above-mentioned DTT, Romania has the right to tax

the capital gains derived by a non-resident investor from the sale of the shares in an entity whose major assets are Romanian real estate. If this is the case, any capital gains received upon a future exit are subject to 16% Romanian corporate income tax, save for the case where the seller is tax resident in a treaty country and has maintained a participation of minimum 10% in the target`s capital for at least 1 year prior the sale.

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

The Romanian Fiscal Code provides for VAT grouping which may be implemented in certain specific conditions.

However, fiscal unity is not available in Romania for CIT purposes. Nevertheless, foreign companies carrying out activities in Romania via more than one permanent establishment (PE) would be able to consolidate all Romanian income and expenses attributable to the PEs at the level of one singe PE which is assigned to handle the CIT liabilities.

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

There is no special tax regime such as a patent box for companies holding intangible assets in Romania.

However, there are certain tax incentives applied for qualifying research and development (R&D) activities. For instance, the CIT payers benefit from an additional 50% deduction of the eligible expenses incurred for the qualifying R&D activity. Also, they benefit from the accelerated tax depreciation which can be applied in respect of the equipment used for qualifying R&D activities. Also, the salary and deemed salary income derived by individuals who perform activities related to R&D and software creation, as defined by law, may be exempt from personal income tax under specific conditions.

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

Romanian tax legislation does not include specific provisions addressing the transfer of ownership over intangibles outside the country. However, the tax law contains general substance over form and anti-abuse / anti-treaty shopping rules which may be applied by the tax authorities, should the context require it.

# 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 obtained (from the sale of shares and/or of assets) by Romanian resident companies registered as CIT payers are included in their ordinary profit and taxed at the corporate income tax rate of 16%. If the seller owns for an uninterrupted period of minimum one year, minimum 10% of the share capital of the target company, the capital gains from selling the shares are not taxable. Capital losses related to a sale of shares are in general tax-deductible, save for the case where the participation meets the above holding conditions (10%, for one year).

Capital gains obtained by non-residents from the sale of shares held in Romanian companies are taxable in Romania at the corporate income tax rate of 16%. Sellers resident in treaty-countries are exempt from CIT if at the date of disposal the above holding conditions (10%, for one year) are met. If the holding conditions are not met, the capital gain may still be CIT exempt in Romania if the double tax treaty concluded between Romania and the seller's country of tax residence awards the right to tax such gains only to the other state (investor's country).

In addition, the corporate seller is required to register for Romanian corporate income tax purposes either directly (in case of EU/EEA tax residents) or by appointing a Romanian tax agent. The tax registration is used for declaring and paying any Romanian capital gains tax owed. Obtaining a tax number and filing nil tax returns is required even if no tax is due in Romania (e.g. by virtue of the applicable double tax treaty). The non-resident should make available a tax residence certificate issued by competent authorities in its residence jurisdiction in order to be able to invoke treaty benefits.

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

The profit reinvested by Romanian corporate income tax payers may be exempt from CIT. Qualifying investments are technological equipment, computers and peripheral equipment, cash registers and machineries for control or billing activities, software programs and the right to use software programs, produced and/or purchased by the company, including under financial leasing contracts, put into service and used for business purposes. Specific conditions should be observed.

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

There is no specific substance requirement concerning foreign holding/finance companies included in the Romanian tax legislation at this stage.

However, the domestic tax legislation contains certain requirements regarding economic substance related to transactions/ activities ("substance over form" principle). For example, in determining the amount of a tax, a levy or mandatory social contributions, tax authorities may disregard a transaction that does not have an economic purpose, adjusting tax effects thereof, or they may reclassify the form of transactions / activities to reflect their economic substance. Specific rules are provided also for artificial cross-border transactions.

In 2016, the Romanian tax administration issued the form which should be filed by foreign legal entities having the actual place of effective management in Romania. After filing this form, the non-resident entity is assigned with a Romanian tax ID number based on which it can discharge its CIT (and other) liabilities in Romania in respect of its worldwide income.

Starting the 1st of January 2018, Romania transposed in its domestic legislation the Controlled foreign companies (CFC) rules provided by ATAD. Generally, an entity should be deemed a CFC if:

- the Romanian taxpayer, alone or together with its associated enterprises, holds a direct or indirect participation greater than 50% of the voting rights/ capital or has the right to receive more than 50% of the respective entity's profits; and
- the profits tax actually paid by the foreign entity or permanent establishment is lower than the difference between the profits tax which would have been paid by the latter in Romania and the profits tax actually paid by that foreign entity or permanent establishment.

If the above conditions are met, the Romanian CIT payer should include in its taxable base the retained earnings of the CFC, such as: interest, royalties, dividends, income from financial leases, income from goods acquired and resold without any economic value being added or with a low value added etc. Certain exceptions apply.

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

The transfer of assets and liabilities is not a taxable transfer if the receiving entity maintains the tax value, tax depreciation method and useful lives of the assets transferred upon the merger or spin-off at the same level as they were prior to the reorganisation process.

The write-off of own shares is not taxable in the case of an 'upstream merger' if certain criteria are met (i.e. the absorbing entity holds at least 10% in the absorbed entity). But the write-off of own shares may be taxable in the case of a 'downstream merger'.

No taxation arises for provisions and reserves that were previously deducted by the absorbed entity and which are not coming from its permanent establishments from abroad, or of the reserves representing tax incentives, if such elements are transferred and maintained as such in the receiving entity's books upon merger. The reduction or usage of reserves that were previously deducted (e.g. by distribution to shareholders, usage for writing-off own shares) triggers corporate income tax liabilities. Also the usage (i.e. for share capital increase or to off-set losses) of legal reserves and reserves representing tax incentives triggers corporate income tax liabilities for the fiscal period when they are used.

No VAT is charged if the transaction qualifies as a transfer of a going concern (in line with the EU VAT provisions). Mergers and spin-offs are by default considered outside the scope of VAT if the assets are transferred to a taxable person.

Fiscal losses brought forward at the level of the surviving entity can be recovered. Fiscal losses brought forward at the level of the target (absorbed company) may also be off-set against the surviving entity's taxable profits.

## MANAGEMENT INCENTIVES

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

Income received by individuals in cash or in-king by virtue of a dependent relationship (e.g. employment, directors' fees) for dependent activities rendered in Romania is subjected to personal income tax and mandatory social security contributions (due by both the employer and employee). The same applies in respect of taxable benefits obtained by these individuals.

However, advantages representing the rights in a qualifying stock options plan received by employees / managers / directors are exempt from personal income tax and social security contributions at grant date and exercise date. Romanian Fiscal Code defines the stock option plan as being a program initiated by a legal entity through which the employees / managers / directors of this entity or of a related party entity are granted the right to buy at a preferential price or to receive for free a specific number of shares issued by that legal entity. The program should provide for a minimum 1 year period between the moment when the right is granted and the exercise date.

In the case of disposal of shares obtained through a stock option plan, the capital gains due by the individuals are determined as difference between the sale price and the fiscal value represented by the preferential acquisition price which includes the transaction costs. In case of shares granted for free, the fiscal value is zero.

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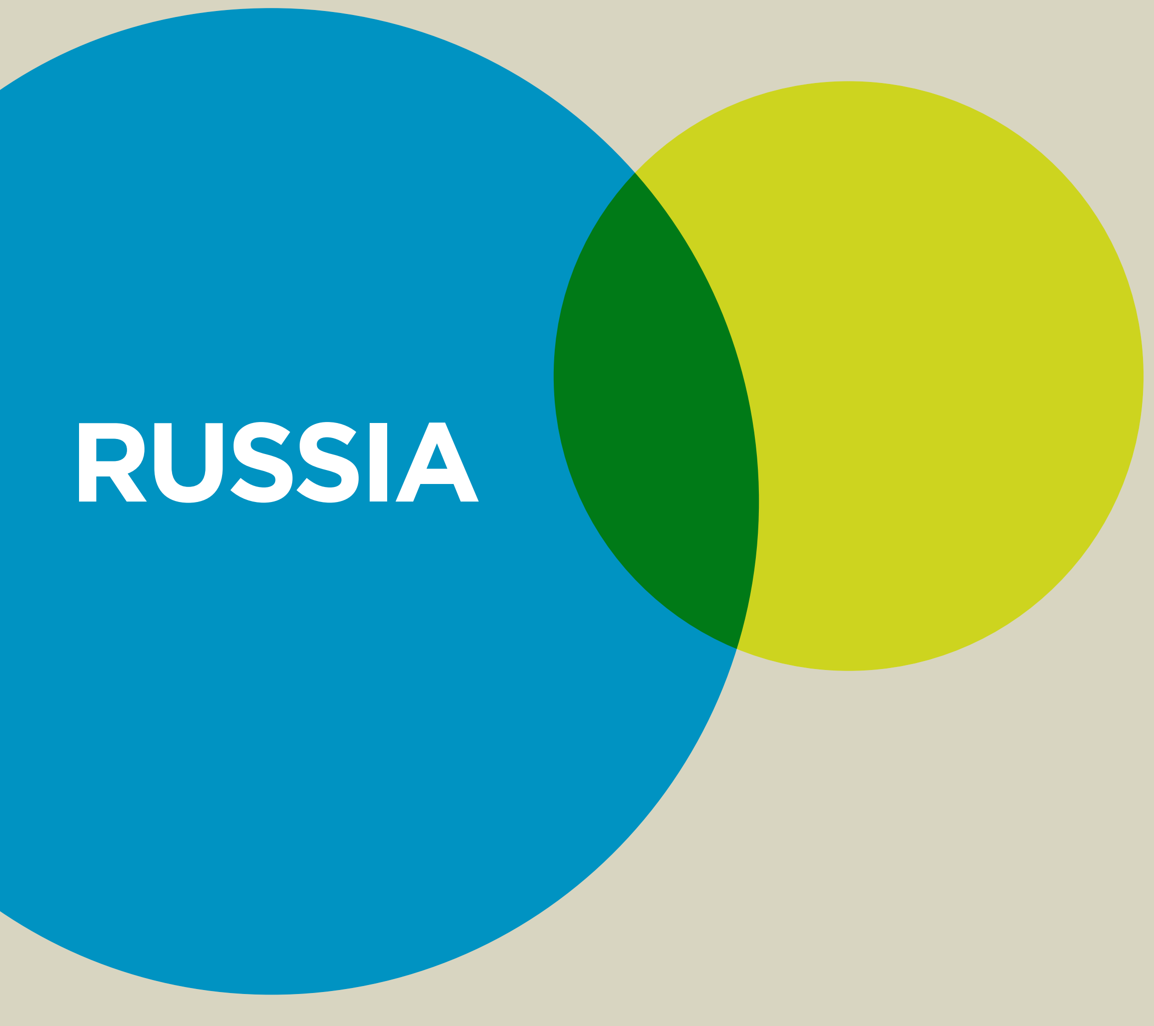
RUSSIA

# RUSSIA

## INTERNATIONAL DEVELOPMENTS

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

Russian tax legislation and court practice has been developed regarding the tax consequences of M&A structures. The structures including debt push-down from the tax view was regarded by competent authorities as a strategy aimed exclusively at tax avoidance. The negative aspects in court practice arisen also regarding the debt financing, since in some cases interest were reclassified into dividends by analyzing the substance of the debt transaction even if formal thin cap rules were not applicable. Also rules regarding the capital gains on shares in companies with significant real estate assets were modified.

### 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?

New legislation has been implemented, including new CFC rules, residency criteria, the definition of beneficial ownership with regards to double tax treaties, CbCR rules, modified thin cap rules, and VAT on digital services provided by foreign companies.

Action 6. In Russia the concept of "beneficial ownership" has already been developed and is applied broadly by tax authorities to any kind of passive income transferred abroad in order to prevent the tax treaty abuse. Failure to meet such requirements may prevent a recipient of foreign income from receiving treaty benefits from a Russian perspective. Anti-avoidance clauses have already been implemented in some DDTs by additional Protocols.

Action 15. The Multilateral Convention to Implement Tax Treaty Related was signed by Russia in 2017. Nowadays the process is on the step of ratification. Russia is going to apply Convention to 66 Double Tax Treaties concluded regarding the following points: restrictions on appliance of DDTs (Russia has chosen the co-called simplified "LOB" clause); restriction of applying lower tax rate for dividends (the requirement of the minimum amount of investments established under the treaty should meet during 365 days); the definition of the PE is expanded (including the definition of the agent, limitations of the notion of preparatory and auxiliary activities).

## GENERAL

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

Sales of share are not subject to Russian VAT. In some cases, the tax authorities try to requalify share deals into sales of assets, and charge VAT on such sale; the courts support them, however, only when there is the clear evidence that the real intention of the parties was to sell the assets. Capital gains on share deals are subject to Russian CIT at the rate of 20% for both types of seller (i.e., the Russian company of the foreign company PE, unless an exemption is applicable). In shares deal the purchaser achieves not only the participation in the equity, but also a control over the company, consequently the credit liabilities as well as tax liabilities are "inherited" by the buyer.

In asset deal the purchaser acquires certain assets in the company, as a result only assets and risks related to them are transferred and not the risks related to the company itself. An asset deal is generally subject to VAT at the rate of 18%. Capital gains on the sale of assets are taxable at the general CIT rate of 20%. The gain is generally calculated as the amount of the sale price above the book value of the asset. The sale of land plots is always exempt from VAT.

## 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?

In statutory accounting the revaluation of assets could be used. Revaluation of assets is not a compulsory procedure and it is regulated by statutory accounting rules and not by tax legislation.

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

According to the Russian tax legislation goodwill is not qualified as an intangible asset. For tax purposes only the following assets could be regarded as intangibles: 1) patents on inventions/ industrial samples/ working models/ selective achievements; 2) know-how; 3) trademark/ tradename/ company name; 4) copyrights on computer programs or databases/ topologies of integrated microcircuits/ audiovisual works. Such assets in order to be recognized as intangibles have to generate income for the company and be justified by necessary documents.

An Intangible asset is subject to amortisation only if its initial value is not less than RUB 100,000 (approx. USD 1,600) and the period of use is more than 12 months. Amortisation of assets is deductible for profits tax purposes in Russia. Amortisation rates depend on the assets' useful life.

Goodwill is recognized in statutory accounting as the difference between the purchase price of an enterprise as a property complex and the net book value of its assets. The amortisation of goodwill is calculated only in statutory accounting.

### 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?

Deductibility of interest expense is limited by thin cap rules in Russia. Thin cap rules are applied to interest on loans received from foreign shareholders (legal entities, individuals) holding directly/ indirectly more than 25% of the debtor capital or more than 50% in each next company in the chain. Interest expenses are deductible provided that the amount of debt does not exceed the debt/ equity 3:1 ratio (12,5:1 for banks and leasing companies). "Excess" amount of interest is deemed as dividends which are not deductible from the tax base and are subject to WHT at the rate of 15% (lower rates could be applied under the DDT).

The new rules have increased the sphere of application of the thin cap rules, including loans made from "sister" companies. Also in recent times the court practice has been developed on this matter. Despite the fact that under the law only fixed-ratio approach is established the tax authorities have started challenging the deductibility of interests even if the formal criteria are not met, courts support such approach and treat the debt as capital investments or equity financing if the real intention of the parties was to avoid taxes by disguising the distribution of profit with the appliance of artificial debt transactions.

Regarding the deductibility of interest during the acquisition and the following merger (debt push-down strategy), please see the answer to the question N 7.

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

Under general corporate and tax rules debt push-down strategies are not directly prohibited, so the companies are allowed to reorganize their assets in every possible legal manner. But the real court practice on this matter has been developed since recently two cases on debt push-down strategies have been regarded in courts. Both cases ended unsuccessfully for the taxpayers in cassation instance, so nowadays the appliance of the debt-push down strategies from the tax view cannot be safe.

Under the debt push-down strategy the acquisition of a target company are financed by debt provided from the foreign parent company. After the acquisition the buyer and the target company merge, so the interest accrued by the buyer are deducted from the target company income for profit tax purposes. Recent years courts determine such kind of M&A transactions as artificial and economically “unjustified”, since they cause additional expenses to arise for the target company which were not associated with profit generating activities. As a result the deductibility of the entire amount of interest was refused.

The worst case-scenario could be if the court does not recognize not only the deductibility of interest, but also the entire debt transaction, which could cause the requalification of the entire amount of interest and the amount of loan paid to the foreign company into dividends. The situations described took place in recent cases, so there is a strong possibility that in the near future the tax authority will challenge the use of such structures.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

According to Russian law equity financing is exempt from taxation. Contributions to the equity could be made in the form of money/ tangible or intangibles assets/ securities etc. Under general rules a contribution to the equity capital is not regarded as a sale of goods or services. Neither such contribution could be regarded as a donation of asset, since the equity-financing is accompanied by a transfer of company’s share to the contributor of assets provided. As a result contribution itself is exempt from VAT. Meantime, contributing entity has to restore VAT on the book value of the assets. Such VAT may be deducted by the subsidiary in which these assets are contributed. Such contribution for the receiving company cannot be regarded as an income for the CIT purposes; for the contributor the amount of the contribution will not reduce the tax base.

The law establishes that the tax exemption for equity-financing is applied only if the contributor acts as an investor expecting to gain a profit in the future (for example, in the form of dividends) and does not use this type of financing only to avoid taxes. Otherwise the tax authority will challenge the tax exemption and requalify the transaction.

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

After an acquisition all losses of a target company are still available. The losses may be carrying forward without any time limitation. There is temporary provision that the profit of the current year may be reduced on amount of the losses carrying forward not more than on 50 %. This rule is applicable until 2021.

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

As it was said before in share deals the buyer gains a control over the acquiring company, as a result all liabilities (including tax liabilities) are "transferred" to the purchaser. For this reason the thorough analysis of the historical/ current and future tax obligations must be conducted. So before the deal the buyer can request the documents issued by tax authorities from the target company at the latest day confirming the tax fulfillment. The buyer also should analyze the corporate structure, the current transaction and relations with clients in order to estimate correctly potential risks in the future, e.g. the VAT refund could be rejected by tax authorities from transactions with contractor who failed to perform its tax obligations, as a result such reject may cause significant financial expenses.

It also should be noted that if by the date of sale of shares the company does not have any tax arrears the tax audit can be performed for 3 years preceding the year in which the decision on the performance of the audit was made, therefore additional taxes could still arise.

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

No stamp duty/ transfer tax or similar taxes are imposed.

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

Acquisition costs for the share deal could reduce the tax base only at the moment of the disposal of shares. The following costs can be recorded: the acquisition price of those shares and the amount of expenses associated with the acquisition. For the asset deals acquisition costs are deductible in the form of depreciation.

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

VAT could be recovered on acquisition costs only for asset deal (except for land plots which are VAT exempt), since the share deals are not subject to VAT.

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

- The foreign company can acquire the shares in Russian company directly or through the local branch. If the branch constitutes the PE on the territory of Russia the capital gains from the sale of share will be taxed under ordinary rules, as for Russian legal entities. Without PE the capital gains is tax exempt unless the situation when more than 50% of the assets of the Russian company directly or indirectly consists of immovable property located in Russia.
- In case holding structure includes the intermediate foreign entities used in order to reduce of WHT on passive income, the foreign company should be aware that the tax authorities could challenge the WHT tax rates applied if the holding company was deemed as a "conduit" or basing on the approach that the recipient does not satisfy criteria of the beneficial owner.
- In order to achieve reduced WHT rate on dividends distribution instead of general 15 % rate the acquisition should satisfy requirements established in the applicable DTT.

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

The process of reorganisation is tax-neutral in Russia, no additional tax is arisen during this process. The tax rights and liabilities of the organised company are not affected by the reorganisation. The tax authorities may not charge penalties to the surviving company that were not presented to the company that ceased to exist.

Tax grouping is established in the Russian tax legislation only for the biggest enterprises which satisfy certain requirement s as amount of revenue, volume of the assets, amount of tax due. Non-Russian company may not be the member of the group.

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

In 2015 an important amendment was introduced regarding the tax consequences of sale of shares by foreign entities in companies with significant real estate assets located in Russia. According to this amendment capital gains is arisen for the foreign company from the sale of shares if more than 50 percent of the assets of a target company directly or indirectly consist of immovable property located in Russia. As a result since 2015 the “indirect” sale of Russian immovable property without taxation has been restricted. Before this amendments only sale of the Russian real estate company was subject to profit tax on the realized capital gain.

Meantime, tax is applicable only if the buyer of the target company is a Russian legal entity or the Russian PE of the foreign company. The sale of shares in a target company (even with significant real estate assets) between two foreign companies is still tax-exempt. But we cannot exclude the possibility that in the near future the legislation on this matter will develop.

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

Russian legislation provides an opportunity to create a consolidated taxpayer group (“CTG”). CTG is a formation based on a consolidation agreement for at least two years. Creation of such group is subject to registration with the tax authorities. CTG is available only for big holdings since the minimum limits on consolidated revenues/ paid taxes/ assets are sufficiently high (not less than RUB 100 bn/ 10 bn/ 300 bn respectively). Members of the CTG are the legal entities holding, directly or indirectly, at least 90% in each of the other group member. CTG could be used only for calculating, paying and filing in reporting forms for corporate income tax with the consolidated tax rate of 20% (other taxes are paid independently by each of the group member). Members of the CTG cannot be in the process of liquidation or bankruptcy.

**Benefits of the CTG:** 1) Members of the CTG consolidate revenues and losses. As a result within one holding losses of the unprofitable entities can be considered and reduce the consolidated tax base; 2) Transactions between members of a consolidated taxpayer group are exempt from the transfer pricing control, except for transactions a subject of which is mining operations.

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

No, the law does not provide such status for companies.

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

In some cases adverse tax consequences could emerge if ownership of intangibles is transferred out of the country within one holding to the parent/sister company without any compensation to the initial owner, especially if the expenses incurred by the initial owner associated with this intangible were significant. Such transactions could be treated as artificial and aimed at disguising the distribution of assets within holding at non-market prices and at creation unjustified expenses for the initial owner. But the consequences could be different depending on conditions of the transaction and the compliance of the compensation with the market value of this intangible.

# 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?

In Russia there is no separate tax established for capital gains. Such gains arisen from the disposal of assets are regulated under ordinary corporate or personal income tax rules. The taxable base from sale of shares is calculated as the difference between the sale price under the transaction and the acquisition historical costs incurred (acquisition price plus additional expenses as legal/finance consulting services). For asset deal the tax base is equal to the difference between the sale price and their net book value (after amortisation costs).

Gains from the sale are subject to the 20 % CIT rate and the 13% personal income tax rate for residents and 30% for non-residents.

Nowadays the exemption from taxation is applicable for the sale of shares in Russian entities. It is available if the taxpayer held shares for 5 years prior to the date of sale and shares were acquired after 1 January 2011. Exemption is also applicable for the shares in Russian joint stock companies, if the shares are non-listed; if the shares are referred to the high-tech/innovation sector of economy or for the shares if less than 50 percent of the assets of a company directly or indirectly consist of real estate.

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

No direct advantages are granted by law.

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

Tax authorities pay close attention to the matters of economic justification and the real purpose of transactions, and their context. In court practice the concept of “unjustified tax benefits” has already been used for many years (nowadays it is also incorporated into legislation), according to which taxpayers must record transactions according to its substance. Rules are applied in order to minimize the tax avoidance and determine the main purposes or transactions. This concept is a general rule and could be applied for debt financing (in order to reclassify interest into dividends) within holdings or for M&A reorganization purposes and etc.

Also tax authorities apply beneficial ownership rules by rejecting the appliance of lower beneficial rates under the DDT to transactions with “conduit” companies. For this reason the tax authority examines the substance of the foreign recipients.

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

The result of the merger process of several legal entities is the emerging of the new one, which becomes a legal successor of all tax liabilities of the former company, irrespective of whether such successor was aware of unpaid taxed (including penalties) prior to the reorganisation process. Along with it the successor has a right to reduce the tax base by the amount of losses made by former companies prior to the reorganisation (losses could be carried forward over the 10 years following the tax period in which the loss was made). Losses made from 2008 to 2017 could be carried forward in the full amount, for the period from 2017 to 2021 the reorganized company could reduce the income only by up to 50% of losses incurred.

Under the general tax rule for the reorganisation in the form of spin-off the new company does not become a legal successor, since the initial company does not cease to exist. Therefore no tax liabilities (unpaid taxes and penalties) are transferred to the spun-off company. There is a exemption if such form of reorganization was aimed exclusively at avoiding the fulfillment of tax obligations, then by court's decision the newly spun-off legal entity would be obliged to fulfill such tax obligations. The transfer of losses to the new company is not applicable for the spin-off process.

# MANAGEMENT INCENTIVES

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

NA.

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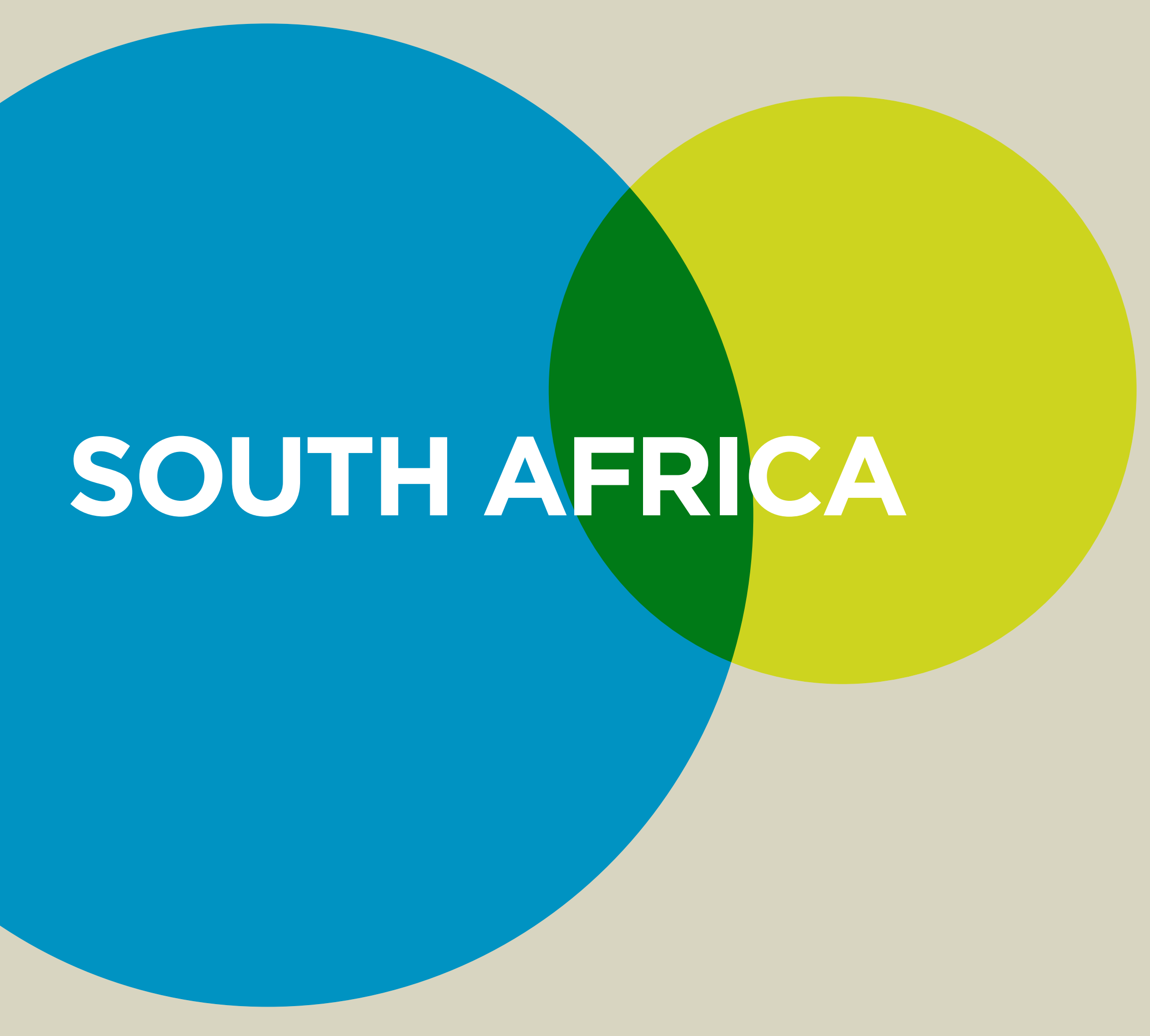

# SOUTH AFRICA

# SOUTH AFRICA

## INTERNATIONAL DEVELOPMENTS

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

The dividend-stripping provisions, aimed at preventing taxpayers from extracting the value from a company by way of tax-free dividends before disposing of the shares, have been amended with effect from 19 July 2017. In this regard, any tax-exempt dividends in excess of 15% of the market value of the shares disposed of by a shareholder, received either as part of the disposal of the shares or within 18 months prior to such disposal, shall be treated as proceeds (where the shares are held as capital assets) and taxable at an effective Capital Gains Tax (CGT) rate of 22.4%, or included in income (where the shares are held as trading stock) and subject to income tax at a rate of 28%.

Therefore, upon the sale of a company, adverse tax implications may arise for the seller where the seller's shares are repurchased by the company by way of a tax exempt dividend (i.e. a share buyback). Any dividends paid by the company to the seller within a period of 18 months prior to the disposal of the shares plus the dividends paid to the seller as part of the disposal may be taxable to the extent that such dividends exceed 15% of the market value of the shares.

### 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?

**OECD BEPS actions**

South Africa signed the Multilateral Instrument on 7 June 2017. South Africa has opted to include the principle purpose test, as set out in Article 7, within their Covered Tax Agreements. Additionally, South Africa will determine dual residency of a person other than an individual through a procedure of mutual agreement with the other Contracting State, as set out in Article 4, on the assumption that such other Contracting State has reserved the right for the entirety of Article 4 not to apply to its Covered Tax Agreements.

**EU Parent-Subsidiary Directive and Anti-Tax Avoidance Directives**

These directives are not applicable to South Africa, since it does not form part of the EU.

## GENERAL

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

**Share deal**

In respect the acquisition of shares, the entire corporate history of the entity is assumed by the purchaser, and the purchaser would typically therefore require an in-depth due diligence review and/or comprehensive tax indemnities and warranties. In addition, the purchaser also acquires the tax losses of the target company.

No Value-Added Tax would be levied upon the sale of shares as the supply of shares is an exempt supply for VAT purposes where the purchaser and seller are registered for VAT.

Securities Transfer Tax (STT) is payable upon the transfer of securities (which includes unlisted shares, listed shares, as well as members' interests in close corporations) at a rate of 0.25% on the greater of the consideration given or the market value of the shares in the case of unlisted securities, and the greater of the consideration declared by the acquirer or the closing price in the case of listed shares.

Interest incurred on debt acquired to finance the acquisition of the assets may be deductible (subject to the interest limitation provisions).

There is no step-up in the tax base of the assets held by the acquired company.

**Asset deal**

Where a purchaser acquires assets from a seller, the existing tax liabilities of the seller are not assumed by the purchaser.

The amount allocated to the various assets would become the base cost of such assets in the purchaser's hands for Capital Gains Tax (CGT) purposes, which would, where such base cost is high, result in lower capital gains tax implications upon the disposal of such assets (where the purchaser is subject to South African CGT).

The purchaser may be entitled to certain allowances or deductions on certain assets which are acquired, however, where the purchaser disposes of such assets, a recoupment of allowances or deductions claimed may arise.

In addition, VAT may be payable, thereby increasing the acquisition costs.

Any interest incurred on debt acquired to finance the acquisition of the assets may be deductible (subject to the interest limitation provisions which would apply in instances where the purchaser and the target company are connected persons).

## 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?

None. As the purchase price would be allocated to the shares, the purchase price would be used to determine the tax cost of the shares and would have no impact on the value of the underlying assets.

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

No depreciation may be recognised in respect of goodwill for tax purposes, and the parties should therefore ensure that the purchase price is allocated as much as possible to other asset categories that qualify for tax deductions or allowances.

### 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?

**Asset deal:**

The Income Tax Act No. 58 of 1962 (the "Act") provides that interest will be deductible by the taxpayer where such interest is incurred for the purpose of earning taxable income in the course of a taxpayer's trade. Where the purchaser is a trading entity and acquires the business/assets of the target company in order to derive taxable income from its operations, the interest would be deductible from its income.

**Share deal:**

Generally, interest incurred on debt acquired to fund the acquisition of shares would not be deductible as it would not be incurred for purposes of earning taxable income, as the dividend income earned by shareholders is generally exempt income. However, the Act provides that the purchaser will be entitled to a deduction on the interest incurred for the acquisition of the shares where the target company is an "operating company" and the purchaser would, at the close of the day of the transaction, be a controlling group company in relation to

the target company i.e. will hold more than 70% of the shares in the target company (or a company that is a controlling company in relation to the operating company).

A company will be an “operating company” where such company continuously carries on business in the course of providing goods or rendering services, and 80% of its receipts and accruals constitute “income” in its hands.

The amount of interest which may be deducted by the purchaser would be limited by the interest limitation provisions of the Act, in terms of a formula which provides that the taxpayer may not deduct interest exceeding 60% of its so-called “adjusted taxable income” in any year of assessment. Any interest which is not deducted may be carried over and deducted in the following year of assessment. The interest deduction limitation would not affect the purchaser too adversely where the acquiring entity has a high “adjusted taxable income”.

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

Typically, a South African intermediary holding company is incorporated by a foreign purchaser as a vehicle to purchase the shares in an existing target company, which newly incorporated intermediary holding company may then incorporate a subsidiary which will then acquire debt to acquire the shares of the target company. The business and/or assets of the target company are then acquired (by either the intermediary holding company or the subsidiary of the intermediary holding company) utilising the tax roll-over intra group transaction relief provisions of the Act. As the debt will be incurred by the entity which will be conducting the trade, the interest incurred on the debt to acquire the assets of the target company should be deductible, subject to the interest deduction limitations (see 6 above).

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Where financing is provided to a company by way of an equity injection, the amount will constitute the Contributed Tax Capital (CTC) of the shares. Dividends tax will not be levied on the return of such CTC to shareholders. Additionally, such return of CTC (in the absence of a repurchase of shares) will not result in a taxable capital gain for the shareholder, unless the CTC returned exceeds the tax carrying value of the shares in the hands of the investor. The amounts invested may therefore be extracted by the shareholder without adverse tax implications.

Venture Capital Companies’ investors enjoy an immediate tax deduction equal to 100% of the amount invested, through an equity subscription, with no annual limit or lifetime limit. Such deduction results in a reduction of the tax carrying value of the investment in the hands of the investor. Certain provisions apply in obtaining the relief.

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

The tax losses of the target company are retained by the purchaser in the case of a share deal, but not where assets are acquired.

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

There are no specific items to be included in the scope of a due diligence in South Africa.

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

STT is levied upon the transfer of shares in listed and unlisted companies at a rate of 0.25% on the greater of the market value of the share or the consideration given in the case of an unlisted share, and the greater of the consideration declared by the acquirer or the closing price in the case of listed shares. STT is payable by the

company which issued the share in the case of an unlisted share or the person who transfers the share in the case of a listed share, but may in both scenarios be recovered from the person to whom the share was transferred.

VAT is not payable upon the transfer of a share as such transfer is an exempt supply.

Transfer duty is payable upon the transfer of shares in a residential property company, which is a company (other than a REIT) which holds property which constitutes residential property.

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

Costs incurred to acquire shares/assets

**Share deal:**

Where the purchaser is a share trader, the shares would likely constitute trading stock and the acquisition cost will be deductible from the purchaser's income. However, the Act contains a provision which deems any expenditure incurred in respect of an equity share to be of a capital nature if that equity share had at the time of that expenditure been held for a period of at least three years. Should this deeming provision be applicable, the cost incurred to acquire the shares and deducted will be recouped.

**Asset deal:**

Where assets are acquired which qualify for deductions or allowances, the purchase price will be allocated to such assets and the purchaser will be entitled to claim the applicable deductions or allowances.

*Costs incurred in relation to advisory services:*

Generally, fees relating to advisory services provided by financial and legal advisors etc. incurred by a purchaser would not be deductible as such fees would generally be regarded as being expenditure of a capital nature. With regard to certain finance charges, depending on the nature of the charge, such charges may be deductible. The deductibility of advisory fees would be dependent on the contractual nature of such fees. Therefore, fees incurred in relation to the funding of the transaction could possibly be structured in a manner which would render same as deductible.

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

Costs incurred to acquire shares/assets

**Asset deal:**

An input tax credit may be claimed by the purchaser where VAT was charged on a supply of goods or services made to the purchaser and the purchaser utilises the goods or services acquired in the course of furtherance of its enterprise for the purposes of making taxable supplies.

Where the purchaser acquires the business (or part thereof) of the target company as a going concern as envisaged in section 11(1)(e) of the VAT Act, VAT will be payable at a rate of 0%. In order to qualify for the zero-rating, the following requirements must be satisfied: both parties to the transaction must be registered for VAT and agree in writing that the business is sold as a going concern, the business disposed of must be capable of separate operation and must be an income-earning activity on the date of transfer, the assets which are necessary for the carrying on of the business must be transferred to the purchaser, and the purchase price is inclusive of VAT at a rate of 0%.

**Share deal:**

No VAT liability would arise upon the acquisition of shares as the supply of shares is a supply of financial services, which is an exempt supply for VAT purposes.

Costs incurred in relation to advisory services

**Asset deal:**

In respect of an asset deal, an input tax credit may be claimed by the purchaser where VAT was charged on a supply of services made to the purchaser, and the purchaser utilises the goods or services acquired in the course of furtherance of its enterprise for the purposes of making taxable supplies.

**Share deal:**

Generally speaking, VAT incurred on fees for advisory services are not deductible for VAT purposes as the acquisition of shares is not attributable to a taxable supply for VAT purposes as no taxable income will generally be generated from the shares acquired. It appears as though the current policy of SARS is that they require that there must be a direct and immediate link to a taxable supply for VAT on an expense to qualify as input tax – the ultimate purpose of the expense is disregarded by SARS. However, the phrase "in the course of" in the context of the claiming of input tax, requires that there must be some relationship between the consumption or use of the service and the making of taxable supplies – no direct or immediate link to taxable supplies is necessary.

This issue remains a contentious one for VAT purposes and is guided by domestic and foreign case law.

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

Foreign purchasers should consider the appropriate acquisition vehicle when structuring the acquisition of a South African target company. In this regard, the purchaser may elect to structure the acquisition through a South African intermediary holding company, a subsidiary or a branch.

The incorporation of a local intermediary holding company offers the purchaser limited liability protection (i.e. the intermediary holding company is a separate legal entity and the liability of the shareholders is limited to the value of their shares). Any dividends received by the local intermediary holding company from the SA operating company would be exempt from income tax and dividends tax (levied at a rate of 20%), and interest received from local operating companies would not be subject to interest withholding tax (levied at a rate of 15%). The local intermediary company could therefore be utilised as a vehicle for reinvestment. However, any expenditure incurred by the intermediary holding company would likely not be deductible from its income as it arguably would not be incurred in the production of its income or in the course of its trade.

The purchaser may also elect to operate through a local subsidiary or a branch of the foreign purchaser which is registered in South Africa. A South African resident company is taxed on its worldwide income at a rate of 28% (subject to the applicable DTA which may reduce the rate), while a branch, which is a non-resident, will be taxed on the income sourced in South Africa at a rate of 28%. Where the branch constitutes a permanent establishment, it will be considered a resident.

Upon the repatriation of funds to the foreign parent company, dividends declared by a subsidiary will be subject to dividends withholding tax at a rate of 20% (subject to the applicable DTA which may reduce the rate), and any interest paid to the parent company will be subject to interest withholding tax at a rate of 15% (subject to the applicable DTA which may reduce the rate). In addition, any profits repatriated to the foreign parent company by way of management and other fees will be subject to transfer pricing rules.

The repatriation of funds by a branch to its foreign parent company will not be subject to any withholding taxes.

Much like a subsidiary, the branch is entitled to a deduction of its expenditure incurred in the production of its income, however, where a foreign parent company operates more than one South African branch, the losses of one branch may be set off against the taxable income of another branch in the determination of the South African tax payable.

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

Yes. Various special rules are provided for in the Act to allow for tax neutral mergers, acquisitions, and restructuring. The Act specifically provides for asset-for-share transactions, amalgamation transactions, intragroup transactions, unbundling transactions and liquidation distributions (tax roll-over relief provisions), each with specific requirements which must be met by the parties to the transactions before they will be applicable.

South African has no "group tax provisions".

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

The Act contains provisions relating to the taxation of Real Estate Investment Trusts (REITs). A REIT is a resident company the shares of which are listed on a recognised exchange as defined in the JSE Limited Listing Requirements. Essentially, the Act allows for a "qualifying distribution" to be made by a REIT or a controlled company (a company that is a subsidiary of a REIT) for which the REIT or controlled company that is a resident gets a deduction from its income for the prior year of assessment to which that qualifying distribution relates. A "qualifying distribution" means dividends paid or payable by the REIT or a controlled company or interest incurred in respect of debentures that form part of a linked unit in that company where 75% of the gross income of that company consists of "rental income".

Amounts distributed by a REIT are fully taxable in the recipient's hands. Where such distribution is in the form of a dividend, the dividend is not exempt from income tax in the recipient's hands. This exclusion from the dividend exemption also applies in respect of dividends distributed by a controlled company.

There are a number of further specific provisions dealing with the taxation of REITs and controlled companies, including, inter alia, provisions dealing with the receipt or accruals by a REIT or a controlled company in respect of a financial instrument, the disallowance of deductions in respect of immovable property and specific rules in respect of the receipt or accrual of amounts of interest in respect of debentures forming part of a linked unit.

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

No.

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

No.

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

The seller of the intangible assets would be subject to CGT upon the disposal of the intangible assets.

Additionally, where such ownership of intangibles is transferred by the resident to a non-resident which is a connected person (20% or more voting rights / equity share connection) and going forward a fee (royalty) is paid by the resident, or a resident connected persons to the first resident, to the non-resident connected person, a deduction will not be allowed for such fee.

## 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?

CGT is payable by South African tax residents on the capital gains arising from the disposal of capital assets.

Non-residents will only be subject to CGT upon capital gains arising from the disposal of:

- immovable property situated in South Africa
- any interest in or right to immovable property situated in South Africa where more than 80% of the market value of the interest at the date of the disposal relates directly or indirectly to South Africa immovable property which is not trading stock (i.e. a "property rich company"); or
- Any asset effectively connected with a permanent establishment of the non-resident in South Africa

An "interest in immovable property" would include equity shares in a company where more than 20% is held (together with connected persons) in the company being disposed of. Therefore, where a non-resident acquires an interest in a South African property-rich company, such non-resident will be liable for CGT upon the disposal of such equity shares, subject to treaty relief

Only the proceeds received upon the disposal of assets in excess of the base cost of the assets will be included in the taxpayer's income and be taxable at the CGT rate applicable to the particular taxpayer. In this regard, the following rates are applicable:

- 40% inclusion in the case of a natural person
- 80% special trust; and
- 80% in the case of a company

Where a non-resident disposes of immovable property in South Africa or an interest in a South African property rich company, the transaction may be subject to withholding tax. The purchaser will have a duty to withhold a portion of the purchase consideration where tax is due on the transaction, and remit this to SARS. The amounts to be withheld amount to 7.5% of the purchase price where the seller is a natural person, 10% if the seller is a company and 15% if the seller is a trust. This amount will be allocated towards settling the CGT liability of the non-resident seller, who will be obligated to register as a taxpayer with SARS for purposes of making payment of its CGT liability.

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

No.

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

There are no specific substance requirements for obtaining/maintaining South African tax residency.

Foreign incorporated companies will be tax resident in South Africa when they are effectively managed in South Africa. South African incorporated companies will automatically be South African tax resident, unless they are exclusively resident in another country by way of a DTA.

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

No.

## MANAGEMENT INCENTIVES

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

The tax considerations will be dependent on the type of incentives provided to the employees. Where the employees are paid a bonus upon the successful conclusion of the transaction, such bonus would constitute "remuneration" and be included in the income of employees and taxable at their respective rates.

Should the employees be incentivized by way of being awarded shares in the company, the tax implications for the employees would be dependent on whether the employees are entitled to freely dispose of the shares for a consideration equal to the market value thereof (i.e. whether the instruments are "restricted" or "unrestricted"). In the event that the shares can be freely disposed of by the employees at market value (i.e. unrestricted), the market value of the shares on the date that the shares are awarded to the employee, less any consideration paid by the employee for the shares, would be included in the employee's income. Where the shares cannot be freely disposed of by the employee, no tax implications would arise at the time that the shares are awarded. Upon the lifting of the restrictions on the disposal of the shares, the market value of the shares on that date, less any consideration paid by the employee for the shares, would be included in the employee's income.

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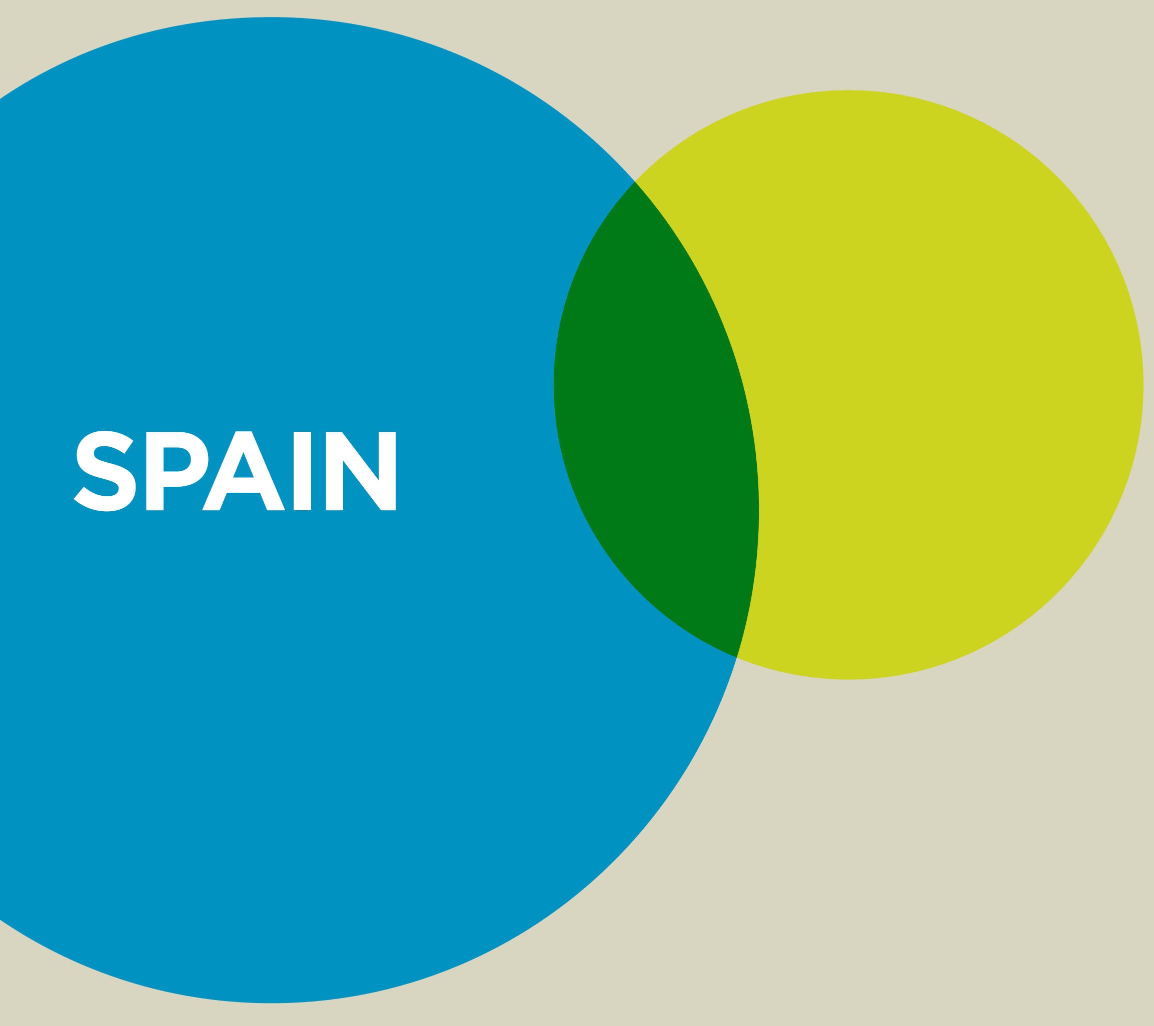

# SPAIN

# SPAIN

## INTERNATIONAL DEVELOPMENTS

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

A new Corporate Income Tax (CIT) Act, which was approved on November 27, 2014 and entered into force on 1 January 2015, substantially modified the CIT regime previously in force. Likewise, certain tax measures modifying the CIT Act were approved in December 2016. Since 2016, no further relevant changes have been introduced in the CIT Act. The main aspects being modified are the following:

- The scope of the participation exemption on dividends and capital gains on transfers of shares, which was previously in force only for foreign subsidiaries, has been extended to domestic source dividends and capital gains. Likewise, the requirements to have access to the exemption have been modified.
- Losses on the transfer of investment qualifying for the participation exemption or permanent establishments are non-deductible (measure in force for fiscal years commencing on or after 1 January 2017).
- The tax treatment of capital gains obtained by EU corporate investors on the sale of Spanish subsidiaries has been amended in order to align it with the tax treatment of those obtained by Spanish resident corporations.
- The deductibility for tax purposes of merger goodwill disappears as a mechanism for avoiding double taxation and the requirements for amortization of goodwill acquired following an asset deal become more flexible.
- The rules regarding the deductibility of financial expenses have been modified, restricting the effectiveness of traditional structures which were implemented to finance acquisitions and push-down the debt.
- NOLs can be carried forward in future years without a time restriction, but the taxable base that can be offset yearly against NOLs has been limited. Likewise, the anti-NOL trafficking rule has been modified.

Specific CIT legislation is applicable in the Basque Autonomous Community, which has autonomous legislative powers in tax matters. Companies subject to Basque autonomous regulations may benefit of significant tax advantages: dividends received and capital gains on transfers of participations are generally exempt, while impairments and losses on the transfer of the participations can be deducted; goodwill embedded in the acquisition price of the participations may be deducted; losses of foreign permanent establishments may be deducted, while the income is exempt. The main specialties of Basque tax regulations are explained below.

### 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 DIRECTIVE?

Spain has partially adapted the CIT regulations to some of the measures proposed under some of the OECD BEPS action plans (and certain new amendments may be implemented in the short term) and Spanish regulations set forth a wide range of anti-abuse rules which are in line with the principles stemming from the OECD BEPS works, among others:

- An anti-abuse rule regarding hybrid instruments which limits the deductibility of expenses with related companies which, as a result of a different tax classification at the level thereof, do not generate income or generate exempt income or income subject to a tax rate of less than 10 percent
- A limitation to the access to the participation exemption regime of hybrid instruments has been introduced, by which the participation exemption does not apply when dividends distributed by a non-resident subsidiary generate a deductible expense at the level thereof

- Specific restrictions are laid down as regards the tax treatment of some hybrid instruments (i.e. participating loans, return on certain types of equity instruments, among others)
- The Spanish CFC rules, patent box and transfer pricing rules were modified as well to adapt them to the OECD BEPS recommendations. The Spanish government is aiming at slightly modifying the patent box regime, thus, the said regime may be adapted in the short term again

Anti-abuse rules have also been included in the Basque CIT regulations, including those related to patent box and transfer pricing.

On the other hand, Spain does not have a model Double Tax Treaty (DTT) or a standard anti-abuse clause. However, it has generally tried to introduce anti-abuse rules in the DTTs that it signs -specially the most recent ones- and, where the old DTTs are renegotiated, anti-abuse clauses are in most cases included. Likewise, Spain is a member of the OECD and has signed the Multilateral Instrument. Thus, the Spanish DTT network will be modified by the MLI after its entry into force.

As regards to the amendments to the EU Parent-Subsidiary Directive, Spain already has an anti-abuse rule in place according to which the domestic exemption implementing the EU Parent-Subsidiary Directive does not apply if the parent company is located in a tax haven or if the majority of its voting rights are held, directly or indirectly, by an individual or legal entity not resident in the EU or a country in the European Economic Area with an effective exchange of information with Spain, unless the parent company has been established to operate on valid economic grounds and for substantive business reasons.

Finally, as a general rule, the Spanish tax regime has substantially implemented the measures which are proposed by the Anti-Tax Avoidance Directive. However, there are certain rules that would foreseeably need to be modified to fully align them with the said Directive:

- the limitation to deduct borrowing costs for CIT purposes should be computed on the operating income excluding dividends from qualified subsidiaries (dividends are computed under the current rule)
- implement new rules on hybrid entities; and
- Spanish GAAR, exit tax and CFC rules already exist (and are generally in line with ATAD) but minor adjustments may be needed as well

## GENERAL

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

**A) Share deal**

Tax advantages:

Acquisitions of shares generally do not have immediate implications for the buyer.

Under Basque tax regulations the buyer may benefit from an indirect deduction for the depreciation of goodwill or any latent gains existing in the target by means of the recognition of impairment in the value of the investment in the target or by means of a special deduction for the value of the target's goodwill embedded in the purchase price, as explained in section 4 below.

The target is entitled to carry over its tax attributes (such as NOLs or tax credits).In Spain NOLs can be carried forward with no time limit (the carryback is not permitted). However, the amount of NOLS yearly offset is limited. Under certain circumstances the right to offset NOLs can be limited (anti-NOLS trafficking rules).

Under Basque CIT legislation, as of 1 January 2018, the amount of NOLS that can be yearly offset has been limited (generally, to 50% of the taxable income), but the period in which NOLs can be carried forward has been extended from 15 to 30 years.

Tax disadvantages:

In share deals the acquired entity (target) remains in existence, and any of its historical or contingent liabilities remain with it after the completion of the transaction.

The basis in the target's underlying assets carries over and is not stepped up. Consequently it is not possible for the buyer to benefit from the additional tax amortization or depreciation of underlying assets. Nor can they benefit from the additional price paid that should be attributable to the goodwill of the business carried out by the entity whose shares the buyer acquires. The rules foreseen in the previous CIT Act which allowed for the step-up and deduction of merger goodwill have been abolished. However, the deduction of merger goodwill is still possible under Basque tax regulations.

**B) Asset deal**

Tax advantages:

In a taxable asset acquisition, the purchase price paid by the buyer allocated to each asset will be regarded as its tax basis. Such allocation is often a contentious issue for parties to the transaction, as the buyer and seller's interests in this respect may differ. The tax basis of the assets acquired should be stepped up to represent the assets' fair market value. This step-up may increase the amount of the future tax depreciation or amortization deductions corresponding to the assets acquired. The portion of the purchase price not allocated to specific assets will be deemed to be attributable to goodwill in the case of acquisition of a business from an accounting point of view.

From a buyer's perspective it is generally preferable to acquire business assets directly (to the extent the buyer can obtain a step-up in the assets' tax basis and could record amortizable goodwill). In Spain sellers are generally not inclined to structure sales transactions as asset deals, as a seller might prefer to avoid the double layer of taxes (at the level of seller and its shareholders if they are not exempt) that could result from an asset deal. However, circumstances that might make the seller lean towards an asset deal include the existence of a pending offsetting of NOLs (although the potential limitations to offset them should be taken into consideration), or, from an economic perspective, when the seller can factor into the sale price the buyer's potential savings in connection with the step-up in tax basis of the assets transferred, among others.

Tax disadvantages:

The target's existing tax attributes, such as net operating losses (NOLs) do not carry over to the buyer.

Under Spain's general tax law rules an acquirer party (the buyer) may be deemed to be jointly liable for pre-closing tax liabilities of a target business if the transfer is deemed to constitute a transfer of an on-going concern. In such a case the buyer may be deemed to be the successor of the seller in the business acquired. Consequently, it is crucial to analyze in detail the nature of assets acquired in every due diligence process. If the assets acquired are standalone assets not deemed to constitute an on-going concern the pre-closing tax liabilities related to such transferred assets, in principle, will remain with the seller unless there is a contractual agreement specifically providing for the transfer of such liabilities to the buyer.

To limit potential tax liabilities resulting from the asset acquisition the buyer may request from the Spanish tax authorities a certification in respect of the tax liabilities and pending penalties due by the seller. This certificate has a binding effect for the Spanish tax authorities and a tax audit could only demand payment for the amounts shown therein.

Asset sales may also be subject to Value Added tax (VAT) at the applicable VAT rate (the general VAT rate is 21 percent). If what is being transferred is a going concern, VAT would not apply. If real estate property is transferred

within the context of a going concern, the transfer would in principle be subject not to VAT but to Transfer Tax (TT) at a rate that would vary between 6 percent and 11 percent (depending on the Spanish region that would be entitled to tax the transfer). Likewise, the transfer of real estate may lead to the accrual of local taxes such as the tax on the increase of the value of urban land.

Asset purchases may also give rise to relevant non-tax issues. For instance, from a corporate law perspective an asset purchase may sometimes not be advisable where licenses, agreements and contracts might not be transferred (or renegotiated) without incurring additional costs or a cumbersome administrative procedure.

## 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?

In principle there are no special provisions in the Spanish CIT law that provide a step-up in value of the target's underlying assets upon acquisition of its shares.

Under Basque regulations the acquirer may, subject to certain requirements and anti-abuse provisions, take an indirect deduction for the depreciation of any latent gains existing at in the target at the time of acquisition by means of the recognition of an impairment of such investment. A step-up of the assets may also be achieved through a merger, whereby the acquiring company absorbs the target after purchasing the target's shares (see section 5 below)

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

The CIT regulations state that goodwill acquired following an asset deal can be amortized for tax purposes over a period of 20 years (at a maximum 5 percent annual rate). This will not be applicable to the goodwill acquired prior to 1 January 2015 from entities which form part of the same group of entities.

Under Basque regulations the maximum deductible depreciation rate for goodwill is 12.50%.

As mentioned, the new CIT Act foresees that the underlying goodwill embedded in the shares being acquired (i.e., the difference between the book value of the target and the purchase price paid for it that cannot be allocated to other assets and/or liabilities) cannot be amortized for tax purposes when a further merger between buyer and target takes place.

Under Basque regulations, subject to certain requirements and anti-abuse provisions, the buyer can deduct for tax purposes at a maximum 12.50% yearly rate the goodwill embedded in the acquisition price of the shares (without the need of absorbing the target). This deduction does not require an impairment to be booked. The acquiring entity may absorb the target and book this as a merger goodwill which can be deducted at a maximum yearly rate of 12.50%.

### 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?

From 2012 onwards, thin capitalization rules previously in force were replaced by two new relevant measures:

Borrowing costs for the relevant fiscal year are not deductible if they relate to debts generated within the corporate group and incurred to acquire, from other entities in the same group, holdings in capital or equity of any type of entity, or to make contributions to capital or equity of other group entities except if the taxpayer evidences the existence of valid economic reasons for performing these transactions.

Net borrowing costs over and above a ceiling equal to 30 percent of the operating income for the period are not deductible. This ceiling has been established subject to the following rules:

- Net borrowing costs for the tax period amounting to EUR1M or less will be deductible in all cases
- The portion that is not deducted in one period can be deducted in another period when operating income is higher or borrowing is lower applying certain rules

The above ceiling will not apply to credit institutions and insurance companies.

Under Basque regulations the general limitation to the deduction of interest (30% of the operating income) has been introduced as of 1 January 2018 for taxpayers within a group, with related entities or with permanent establishments abroad. This general limitation does not apply to net borrowing costs for the tax period amounting to EUR3M or less, which will be deductible in all cases. This limitation can be avoided if the leverage ratio (equity / total assets) of the taxpayer is equal or lower to the leverage ratio of its group. Also, a higher limit of deduction may be claimed, based on the ratio between net financial expenses and operating income of the group. The former 3-to-1 thin capitalization rule applies to net debt with non-related entities still applies to taxpayers who are out of the scope of the previous general limitation.

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

The use of a Spanish special purpose vehicle (SPV) by a foreign buyer to carry out the acquisition of a Spanish target, coupled with the Spanish tax unit regime, has traditionally been a common way to push-down the indebtedness related to the acquisition of a Spanish target.

Streaming-up accumulated reserves and equity from affiliated companies to the SPV in exchange for debt, selling assets from the affiliated companies to the SPV, and merging the SPV with the target in a downstream merger were also strategies to consider for pushing down debt.

All these strategies must be carefully analyzed to ensure that they are not challenged on the basis of the general anti-abuse provisions, as well as to comply with the transfer pricing rules and, most significantly, with the requirements and limitations recently introduced regarding interest deductibility, which have substantially restricted the ability of companies to push down debt connected to acquisitions of equity interests by Spanish companies.

A specific restriction is laid down in cases of acquisitions of holdings in other entities if, thereafter, the acquired entity is included in the tax group of the acquirer or is merged with the acquirer, with a view to preventing the acquired activity from bearing the finance cost incurred on its acquisition. In this situation, borrowing costs related to the acquisition of these holdings over and above a ceiling equal to 30 percent of the operating income of the acquirer for the period are not deductible. For these purposes:

- The restriction is limited in the case of a merger or an inclusion in a consolidated tax group taking place within 4 years following the purchase
- It is possible to offset the finance costs that are not deductible for this reason in the following years (according to the general rules on deductibility of finance costs)
- This limitation on the deduction of finance costs will not apply if the debt incurred to finance the transaction does not exceed 70% of the acquisition cost of the shares and the debt is repaid at the rate of at least 5 percent annually for 8 years (until the debt reaches 30% of the acquisition price).

Under Basque regulations the above specific limitations to the deduction of interest in cases of acquisitions of holdings in other entities also apply as of 1 January 2018.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No.

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

Generally speaking, they are. However, anti-NOL trafficking rules apply where all of the following circumstances occur:

1. The majority of the share capital of the target is obtained by a person or entity or group of persons or entities after the end of the fiscal year in which the tax loss was generated
2. The persons/entities taking control of the company held less than 25% of the share capital in the company at the end of the fiscal year in which the tax loss was generated
3. The acquired entity falls under one of the following circumstances:
   - It had not been carrying out an economic activity in the 3 months prior to the acquisition
   - It carries out an economic activity in the 2 years following the acquisition which is different from or additional to the one carried out before the acquisition, which implies a net revenue in the years following the acquisition which is 50% higher than the average net revenue obtained by the entity in the 2 years preceding the acquisition
   - It is qualified as an instrumental entity; or
   - The entity has been de-registered from the tax entities' registry.

Under Basque CIT, anti-NOL trafficking rules only apply if the acquired entity has not carried out an economic activity in the six months prior to the acquisition.

## 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, there is not specific documentation to be required.

The statute of limitations in Spain is four years. Thus, a review of all tax obligations of the last 4 tax periods opened to a tax audit is required. Exceptionally, in Spain, the right of the Spanish Tax Authorities to audit NOLS and tax credits which have been off-set or are carried forward prescribes in 10 years, starting to count from the date after filing the CIT return corresponding to the fiscal year in which the tax loss or tax credit was generated. Once the 10-year period is expired, the Spanish Tax Authorities are not entitled to audit NOLS or tax credits; nevertheless, the taxpayer must be capable of demonstrating the origin of the tax losses or tax credit which it is willing to off-set with the exhibition of the tax return and accounting records.

In the framework of an asset deal, the certificate of pending liabilities could be obtained in order to limit the potential joint and several liability of the purchaser (see section 3).

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

The sale of shares of a Spanish company is not subject to any indirect tax, except TT (from 6 percent to 11 percent) if the purpose of the sale is to avoid the tax payable for the real estate properties owned by the companies whose shares are transferred.

Please note that it will be presumed that the purpose of the sale is to avoid tax in the following cases:

- When the transaction results in the buyer gaining control of an entity whose real estate assets located in Spain not destined to a particular economic activity are at least 50 percent of the total market value for all assets or, in the case that the buyer already has a controlling stake, when that stake is increased
- When the transaction results in the buyer gaining control of an entity whose assets include a controlling stake in an entity with real estate assets which fit the previous description
- When the shares received are the consequence of real estate contributed for the incorporation of entities or capital increases, if this real estate is not destined to an economic activity and three years have not elapsed between the date it was contributed and the transaction date.

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

There are no specific restrictions on the tax deductibility, for the purposes of the buyer's CIT, of acquisition costs, as long as these costs give rise to accounting expenses on their profit and loss account. This applies both in the context of share deals and of asset deals.

Impairment losses on shares are non-deductible (Under Basque CIT impairment losses on shares can be tax deductible).

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

In an asset deal, VAT borne on acquisition costs may be totally recovered when the company is entitled to offset 100% of the input VAT. Therefore, companies which do not fall within the scope of Spanish pro-rata rules (i.e. deductible proportional rules) which limit the right to offset input VAT will be able to fully recover VAT. The refund will be requested through the last VAT return filed for a natural year and the Spanish Tax Authorities have to carry out the refund within 6 months following the request or late payment interest will be accrued in favor of the taxpayer.

In order to recover VAT without waiting until the last return of the year, companies may opt for the (voluntary) monthly return regime if certain requirements are met. The Spanish Tax Authorities have to carry out the refund within 6 months following the request or late payment interest will be accrued in favor of the taxpayer (in practice, the term is reduced after the Spanish Tax Authorities approve the first refund).

A share deal is exempt from VAT.

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

Where a foreign buyer acquires a Spanish target, the following aspects should be taken into account:

- Whether dividends and capital gains obtained by the foreign buyer in connection with the participation held in the target would be taxed in Spain
- Whether the investment through a company that benefits from the Spanish holding company regime (the ETVE regime, or entidad de tenencia de valores extranjeros) would be more advantageous from a tax perspective (e.g. from the perspective of future repatriation of funds to a foreign shareholder);
- The financing of the acquisition
- The tax incentives connected to the investment

The ETVE regime provides that dividends and gains derived by non-resident shareholders from their participation in an ETVE that are ultimately related to tax-exempt reserves (due to the applicability of the participation exemption regime) are not subject to tax in Spain (provided the shareholder is not resident in a tax-haven jurisdiction). The part of the gain attributable to the underlying value of foreign subsidiaries qualifying for the participation exemption in excess of their book value (hidden reserves) is also not subject to tax in Spain. The use of Spanish holding companies entitled to the ETVE regime is common among multinational groups as a way to hold investments in foreign jurisdictions that have advantageous tax treaties in force with Spain (e.g. Latin American jurisdictions) and to hold shares of Spanish operating subsidiaries.

Basque tax regulations provide for the exemption of dividends and gains derived by non-resident shareholders from their participation in Basque holding companies that are ultimately related to tax-exempt reserves. Also, the deduction at a maximum 12.50% yearly rate of financial goodwill embedded in the acquisition price of the shares in the target, both in Spanish and non-resident companies, is allowed, subject to certain requirements. Accordingly, Basque holding companies are commonly used for the acquisition of the target.

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

The Spanish CIT law provides for a special tax neutral regime applicable to certain qualifying corporate restructurings (such as mergers, spin-offs, special contributions-in-kind, exchanges of shares representing a company's share capital, among others), based on the tax regime of the EU Merger Directive. Valid business reasons (other than tax) must exist for the transaction to qualify for the tax neutral regime. Under Basque regulations this tax neutral regime may also apply to global transfers of assets and liabilities to shareholders owning 25% or more of the company's share capital.

Likewise, Spanish companies with a common dominant company (holding at least a 75% stake – 70% for entities listed on a stock exchange) can apply the Spanish tax unit regime.

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

Capital gains obtained by non-residents in connection with transfers of shares of companies whose main assets are directly or indirectly real estate located in Spain are deemed to be subject to tax in Spain, at a 19 percent rate. The domestic exemption on capital gains on the sale of qualifying subsidiaries obtained by EU tax residents does not apply if the main assets of the subsidiary are, directly or indirectly, Spanish real estate properties. In cases where a tax treaty is applicable, its provisions must be analyzed to determine whether such gain should be subject or exempt from Spanish taxes, though the vast majority of such treaties allow the source State to impose tax on those gains.

Capital gains obtained by resident entities in connection with transfers of Spanish companies whose main assets are real estate located in Spain are taxed in the same terms as capital gains on companies without real estate at the ordinary CIT rate (25% or 26% in 2018 and 24% onwards under Basque regulations). However, the capital gain may qualify for the participation exemption if the relevant requirements are met.

In either case, it is important to note that Spanish transfer tax (from 6 percent to 11 percent) may apply to transfers of shares in case that it was deemed that the transaction had the objective of avoiding the tax otherwise payable for the transfer of the real estate properties owned by the companies represented by the shares. Transfer tax applies even if the shares transferred are shares of a company that indirectly owns real estate in Spain. The far-reaching scope of transfer tax rules should be borne in mind as transactions involving upper-tier entities could trigger Spanish transfer tax.

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

Spanish companies can form a group and apply a special tax unit regime for CIT purposes. Certain formal requirements must be fulfilled the year before its application.

The tax group is formed by a dominant company and its dependent companies. The dominant company of the tax group must hold a 75% or higher interest, either directly or indirectly, and the majority of the voting rights in the dependent companies at the beginning of the first tax year in which the tax unit regime is applied, and this interest and voting rights must be maintained during the year unless the dependent company is dissolved. The interest requirement is reduced to 70% for companies listed on a stock exchange.

A non-resident company can also be the dominant company of a tax consolidation group, provided that it has legal personality, is subject and not exempt to a tax akin to Spanish CIT, and is not resident in a tax haven. In such case, a representative company in Spain must be appointed.

The main characteristics of the tax consolidation regime are as follows:

- The taxable income of the tax group is the sum of the individual taxable income of each of the Spanish companies forming the group
- The tax losses of any of the companies forming the group can be offset against the tax profits of any of the other group companies
- To determine the tax group taxable income, transactions carried out between group companies are eliminated or deferred. They will be added afterwards under certain circumstances
- Certain rules apply as regards tax losses and tax credits generated prior to the incorporation of a company to a tax unit.

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

The Spanish patent box regime entitles Spanish companies to apply a reduction of 60% on net income that derives from the "granting of the right to use or exploit" certain intangibles. Gains on the disposal of the ownership of such intangibles are also eligible for the regime if the acquirer is a non-resident person.

Intangibles included and excluded from the regime are the following:

- Intangibles included: Patents, drawings or models, blueprints, secret formulas or procedures, rights over information related to industrial, commercial or scientific experiences
- Intangibles excluded: Trademarks, literary, artistic or scientific works, personal rights susceptible to assignment, computer programs and industrial, commercial or scientific equipment.

Certain requirements must be fulfilled in order to apply the patent box regime, which are detailed below:

- The asset must be used by the transferee in the development of an economic activity and it must not generate deductible expenses for the transferor
- The assignee must not reside in a tax haven (except EU and attesting valid economic reasons).
- It does not apply to accessory services (technical or auxiliary services)
- The taxpayer must provide the necessary accounting records to quantify net income.

The reduction applicable to income eligible for the patent box regime is computed as follows:

Reduction= Income x 60% x (Creation expenses x 1.3) / (Creation and acquisition expenses)

Finally, the Spanish Budget Draft Bill for 2018 sets out some modifications which would be effective as from January 1, 2018 (if it is finally approved) as follows:

- Advanced registered software and supplementary protection certificates of medicines and phytosanitary products would be included in the list of eligible intangibles. Conversely, drawings, secret formulas and rights over information related to industrial, commercial or scientific experiences would be excluded
- The procedure to compute qualifying profits eligible for the reduction of the patent box regime would be clarified
- The regime would set forth that losses would be set off against the amount of profits subject to reduction in previous years.

The Basque patent box regime, which is aligned with the OECD nexus approach, provides for a reduction of 70%.

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

As a general rule, the transfer of an intangible asset abroad generates a taxable income for CIT purposes to be taxed under the general rate which shall be computed for the difference between its net book value and its market value. The application of the patent box regime may reduce the CIT payable on the transfer.

Under Basque tax regulations, reinvestment exemption could apply (see section 21 below).

# 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?

**Share deals**

Capital gains obtained by Spanish residents from sales of shares are generally subject to a 25 percent CIT rate (26% in 2018 and 24% onwards under Basque CIT rules). However, a participation exemption regime may apply if the following requirements are met:

- The shares sold must represent at least 5 percent of the target's share capital, or if the minimum 5 percent stake is not held, the acquisition cost must be at least EUR20M and must have been acquired at least one year prior to the sale
- If the target is a non-resident it must be subject to a tax similar to Spanish CIT with a tax rate of at least 10%. This requirement is deemed to be met if there is a tax treaty providing for an exchange of information clause in place between Spain and the target's country of residence
- The exemption will not be applicable to capital gains obtained on the sale of stake held directly or indirectly in instrumental entities
- The exemption will not be applicable to capital gains obtained on the sale of stake held directly or indirectly in entities which fall under the scope of the Spanish CFC rule and the said regime applies, at least, to 15% of their income
- The exemption will not be applicable when the subsidiary is resident in a tax haven.

Taxable capital gains obtained by non-residents are taxed at a flat 19 percent rate. However an exemption might be available further to the provisions of a tax treaty or to domestic law. If the target is a holding company that benefits from the Spanish ETVE regime or is a Basque holding company, the capital gain obtained by the seller derived from the sale of the target's shares might not be taxed in Spain, to the extent of the amount of the target's accumulated tax-exempt reserves (i.e., reserves that ultimately derive from tax-exempt dividends and capital gains obtained by the target as a consequence of the applicability of the Spanish participation exemption regime) and hidden reserves attributable to foreign subsidiaries of the ETVE or the Basque holding company.

Domestic law foresees that capital gains resulting from the transfer of movable property, obtained without a permanent establishment, by residents in an EU member state or by EU permanent establishments of residents in EU member states, will be tax exempt. This exemption will not apply to capital gains obtained in the transfer of shares when one of the following circumstances occurs:

- When the assets of the company consist principally, directly or indirectly, in real estate situated in Spain
- For individuals, when in the 12 months prior to the transfer, the taxpayer held, directly or indirectly, at least 25% of the stake in the transferred entity
- In the case of non-resident companies, when the requirements to apply the participation exemption regime for CIT purposes are not met.

**Asset sales**

If the seller is a Spanish resident company, capital gains derived from asset sales are generally subject to CIT at a 25 percent rate. Any potential capital gain can be offset against NOLs and other negative income, considering the limitations already described. Additionally, the capitalization reserve can be applied (see section 21below).

Under Basque regulations a full exemption of the gain is available subject to reinvestment of the sale proceeds. The general CIT rate is 26% in 2018 and 24% onwards.

If the seller is a non-resident company, capital gains obtained thereby in connection with the sale of assets located in the Spanish territory are generally subject to Spanish taxes, at a 19 percent rate. If the assets sold are attributable to a permanent establishment of the non-resident seller located in Spain, such a sale will be deemed to be a sale attributable to the permanent establishment and accordingly, it will be subject to Spanish CIT (at a 25 percent rate or 26% in 2018 and 24% onwards under Basque regulations).

The access to the domestic exemption for EU movable assets and the provisions of an applicable tax treaty may reduce the tax burden.

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

The CIT Law includes the so-called "capitalization reserve" as an incentive for the reinvestment and capitalization of companies.

Taxpayers subject to the standard tax rate can reduce their tax base by 10% of the increase in their equity provided that (i) this increase is maintained over a period of 5 years and (ii) a reserve is created for the amount of the reduction, duly separated and restricted (as non-distributable) over the 5-year period.

The reduction cannot exceed 10% of the positive tax base prior to the application of this reduction, the inclusion of adjustments for deferred tax assets and the offset of tax losses. If there is insufficient tax base, the outstanding amounts can be applied over the next 2 years, together with that of the year itself, subject to the same limit.

A number of rules are established for determining the increase in equity, mainly excluding shareholders' contributions or variations for deferred assets, which means that as a general rule the equity increase has to come from the year's undistributed income.

Under Basque tax regulations, reinvestment exemption applies to capital gains arising on the sale of tangible or intangible fixed assets used in the company's economic activities, where the full proceeds are reinvested in tangible or intangible fixed assets used for the company's economic activities or holdings of at least 5% in companies engaged in an active business operation (as of 1 January 2018 the reinvestment in shares does not qualify for the exemption). The reinvestment of the proceeds should be completed within 1 year before, or 3 years after, the transfer. The new assets should be held for at least 3 years (5 years for real estate), unless their useful life is shorter.

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

There are not specific substance requirements set forth for regular resident companies, but the access to the domestic participation exemption when investing in companies deemed as purely instrumental as well as certain tax benefits (for instance, benefits for small and medium entities) can be denied where an insufficient level of substance is deemed to exist. On the other hand, the ETVE regime will only be applied to holding companies whose activities (i.e. the management of the stake held in their subsidiaries) are carried out through an adequate organization of human and material means.

As regards non-resident companies, the benefits of a domestic exemption or an applicable DTT may be denied if the foreign company does not have sufficient substance to evidence its effective tax residence in the foreign jurisdiction or if, as a consequence thereof, the relevant structure was regarded as purely tax driven (i.e. merely aimed at benefitting from the relevant DTT or domestic tax advantages).

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

Spain has implemented the provisions of the EU Merger Directive in its domestic system. Consequently, Spanish companies can reorganize its Spanish activities in a tax neutral manner.

This is configured like the standard regime for restructuring transactions and there is a general obligation to inform the tax authorities when transactions eligible for the regime are carried out. (In the case of companies subject to Basque tax regulations an election for the tax neutral regime is required.)

This regime provides for a tax neutral treatment for restructuring transactions (both from a CIT and indirect tax perspective), by providing that:

- Capital gains or losses realized on the transferred assets are not included in the CIT taxable base of the transferor party
- The acquiring entities receive a carryover basis in the assets acquired. The rules governing the qualification of a transaction for purposes of the mentioned regime are complex, and its applicability should be carefully analyzed on a case-by-case basis

The main caveat to consider for tax neutral restructurings under the Spanish tax regime based on the EU Merger Directive is the specific anti-abuse provision that requires the transaction to be carried out under valid economic purposes and not with the sole purpose of obtaining a tax advantage.

## MANAGEMENT INCENTIVES

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

Incentives are granted to managers in order to align the interest of the investors and the managers.

Generally speaking, remunerations derived by the managers are treated as employment income and subject to Spanish Personal Income Tax at the general rate (progressive rate which ranges from 19% up to 48%, depending on the Autonomous Region of tax residence of the manager). A 30% reduction may be applicable for certain long-term incentives. (In the Basque territories reductions up to 50% may be applicable for certain long-term incentives).

Managers can also be remunerated acquiring a stake in the target. The acquisition of a participation at a cost under market value will also be treated as an employment income subject to Spanish Personal Income Tax general rates (see above). The capital gain triggered on the sale of the stake acquired will be taxed at the reduced tax rate applicable for saving income (ranging from 19% up to 23%).

From a Spanish CIT perspective, long-term remunerations are tax deductible when the incentives are satisfied to the managers.

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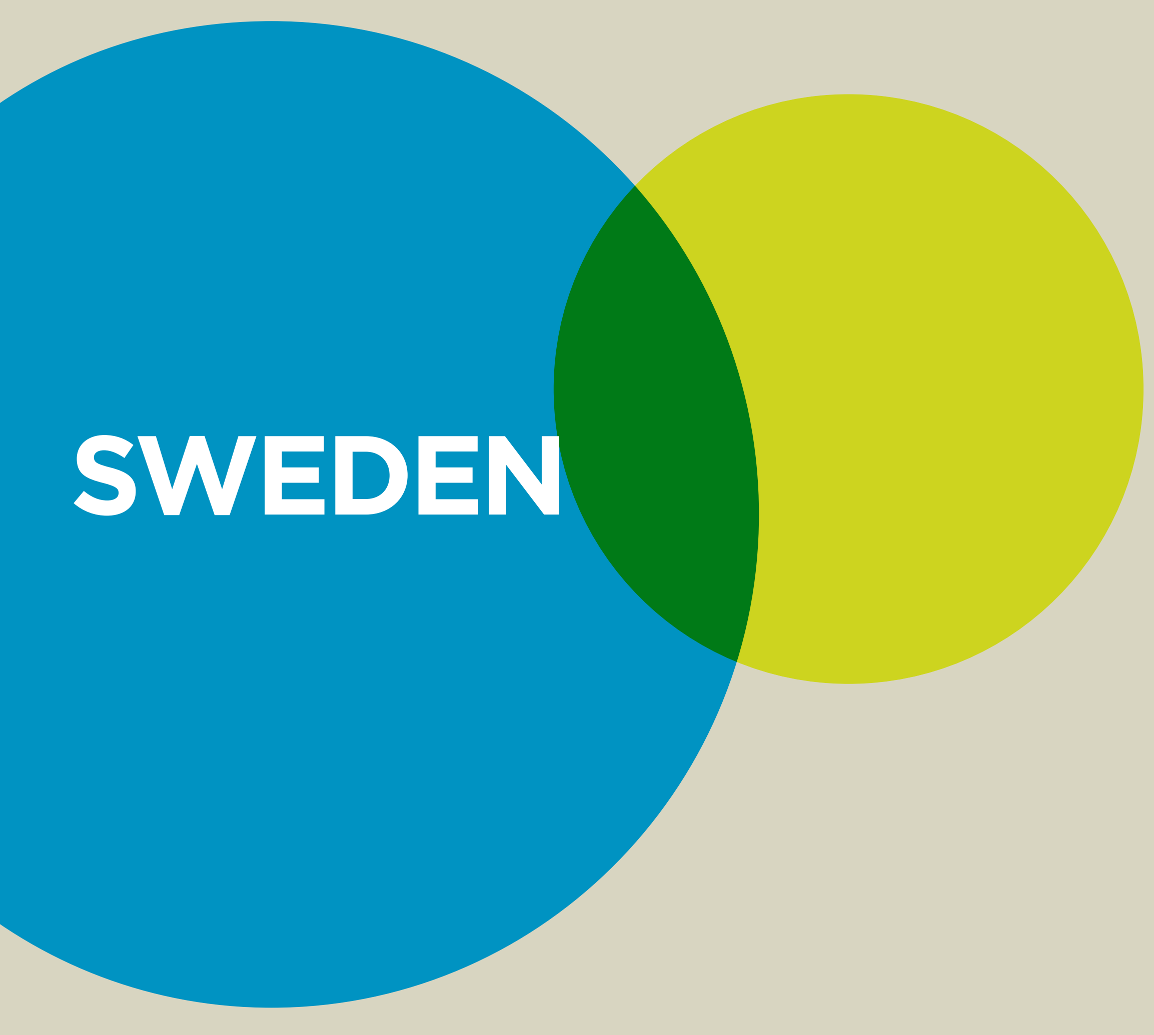

# SWEDEN

# SWEDEN

## INTERNATIONAL DEVELOPMENTS

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

Interest has been fully deductible for Swedish companies in the past, except for interest on certain loans between affiliated parties. According to a new proposal (bill 2017/18:245), interest deduction rules are proposed in accordance with the Anti-Tax Avoidance Directive and will apply to interest that is not non-deductible under the specific limitation rules on intra-group loans.

The proposal is to limit the deductibility of net interest expense to 30 percent of taxable EBITDA. A "safe harbor"-rule is however proposed, and interest is not limited when the net interest expense within a company group is below an amount of SEK 5 million.

The first step is to determine the company's net interest, calculated as interest income less interest expense. A specific tax definition of interest is proposed and includes interest, other expenses for credit, and expenses that are equal to interest. The definition of interest is broader than the definition of interest for accounting purposes and includes, for example, foreign currency exchange gains or losses on loans/receivables in foreign currencies when hedged through a derivative (the profit/loss on the derivative as such is also deemed to be interest in this context).

If the net interest expense exceeds 30 percent of taxable EBITDA, the excess net interest expense is not deductible. Instead the non-deductible net interest expense is carried forward, for a maximum period of six years (there are exceptions to this rule).

For group companies, the proposed rules allow for, if certain requirements are met, a netting of net interest income/expense between the companies in the group where group tax consolidation possibilities are available.

The current limitation rules on loans between affiliated parties will also be amended. Interest is proposed to be deductible if the end recipient is taxed at a rate of at least 10 per cent, or is located within the EEA or a country with which Sweden has an unlimited tax treaty. If the sole or almost sole reason (90-100 per cent) for the debt is to create a significant tax benefit for the group, the interest is also not deductible. There are also further aspects to consider in the assessment (e.g. back-to-back loans and intra-group transfer of shares).

In February 2018, The Swedish Ministry of Finance presented a proposal to amend the current Swedish CFC rules. The proposal was based on the EU's Anti Tax Avoidance Directive. The proposed amendment mainly concerns the so-called white list (countries whose domestic companies are not CFCs), where some jurisdictions has been removed. In addition, specific types of income (e.g. royalties and income from financial activities) are also removed from the white list in relation to several jurisdictions. This means that the scope of Swedish CFC taxation will be broadened.

For VAT purposes, the Swedish Supreme Administrative Court (SAC) has delivered a judgment on deductibility of VAT on external costs attributable to the sale of shares, e.g. legal fees, costs for due diligence. See further below.

### 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?

**BEPS**

The implementation of the BEPS rules in Sweden has in general focused on actions 8-10 and action 13 regarding aligning transfer pricing outcomes with value creation, transfer pricing documentation and country-by-country (CBC) reporting. New rules regarding transfer pricing documentation (master file/local file) and CBC reporting entered into force on 1 April 2017. The documentation rules will apply for the first time for fiscal years commencing

after 31 March 2017. First year covered by the CBC is any financial year starting after 31 December, 2015. The first CBC report should be submitted by the end of the year following the financial year (i.e. by end of 2017 for most MNEs). Entities of a MNE group that have to submit a CBC report need to notify the Swedish Tax Agency (STA) which entity is the reporting entity by the end of the financial year covered by the report (extended to 30 April 2017 for first financial year covered). As Sweden follows the OECD Transfer Pricing Guidelines, no changes in domestic law have been implemented related to action 8-10. The STA has stated that the updated guidelines may be applied both retroactively and going forward. Action 6 provides for changes to the preamble to clarify that tax treaties are not intended to be used to generate double non-taxation. It seems likely that Sweden will conform to the new preamble in future tax treaties. In addition, action 6 provides the inclusion of a limitation of benefits test and principal purpose test. Sweden has not negotiated new treaties following the outcome of the BEPS project. However, it can be assumed that Sweden will in general accept the inclusion of both a limitation of benefits test and principal purpose test in its future treaties (limitation of benefits articles already exists in certain tax treaties, e.g. the treaty between Sweden and the US and the treaty between Sweden and Japan).

As regards the multilateral instrument, Sweden was part of the working group that developed the multilateral instrument, and Sweden was one of the signatories. Sweden included 64 treaties, and approximately half of them are so-called matching treaties. Some treaties were not included since they are already under bilateral negotiations. Sweden chose to include articles 6, 7, 16 and 17, which are all minimum standard articles. In addition, Sweden also included 18-26 on arbitration. Sweden made reservations as regards the other articles in the multilateral instrument (i.e. articles 3-5 and 18-26).

**The amendments to the EU Parent-Subsidiary Directive**

As concerns outbound dividends, the Swedish government is of the opinion that no changes to Swedish tax legislation were needed in order to implement the amendment to the EU Parent-Subsidiary Directive. This is because the Swedish Withholding Tax Act prescribes that withholding tax is levied on outbound dividends if the shares in a Swedish company (the company distributing the dividends) are held in ”such a manner that someone else thereby receives an unjust favor as concerns income tax or exemption from withholding tax”. A requirement for this rule to be applicable is that the shareholder of the Swedish company must hold the shares in the company on behalf of someone else and this third party must thereby achieve a tax benefit. There is limited case law and more or less no preliminary works that describe the scope of the rule. This existing rule has nevertheless been deemed to be sufficient in relation to the general anti avoidance rule in the Parent-Subsidiary Directive.

Effective as of 1 January 2016, dividend income is not tax exempt under the participation exemption regime if the company paying the dividend is a foreign company that is entitled to deduct the amount as interest or similar expense in its home jurisdiction. Note that the provision is extended also to non-EU shareholdings.

Anti-Tax Avoidance Directive (ATAD)

See question 1 above regarding interest limitation rules and CFC taxation.

## GENERAL

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

An acquisition in Sweden is more often a share purchase rather than a purchase of the company’s assets, since capital gains on the sale of shares may be tax-exempt (participation exemption). However, the benefits of asset acquisitions for the purchaser should not be ignored, particularly given that purchased asset goodwill benefits from tax deduction over five years.

For VAT purposes, the acquisition of shares is not subject to VAT while an asset deal may, depending on the situation at hand, be subject to VAT.

**A) Share deal**

Capital gain or loss is calculated as the selling price less the tax base of the shares. The tax base equals the acquisition cost, subsequent capital contributions and sales costs. For certain Swedish shareholders (e.g. companies) capital gains are non-taxable if the participation exemption regime is applicable. For non-residents without a permanent establishment in Sweden, a share deal is a nontaxable event. The participation exemption regime may also be applicable for companies established within the EEA with a permanent establishment in Sweden.

The purchase of a target company's shares does not give rise to an increase of the tax base of that company's underlying assets. Hence, there is no step-up on the basis for tax depreciation purposes and the buyer cannot deduct the difference between the underlying net asset values and the consideration for the shares.

A sale of shares is VAT-exempt. Input VAT on costs related to share purchases may be recoverable, provided certain conditions are met. The SAC in Sweden came to the conclusion that VAT was deductible if the disposal of shares was part of an intra-group restructuring and that the purpose of the supply was to streamline the remining business by allocating funds thereto. The Court also considered that the selling company had not passed on the costs for the transaction on the purchaser of the shares. In conclusion, the Court held that the VAT on the transaction costs was deductible as an overhead cost for the seller. Following this court case, lower Swedish courts have ruled in favor of companies selling shares, but the criteria set by the Court should in our opinion always be contemplated before a company deducts VAT on transactions costs attributable to share deals.

There are no other transfer taxes (however see above on proposed rules of indirect transfer of real estate).

**B) Asset deal**

A purchase of business (assets) usually results in an increase of the tax base of those assets for both gains tax and depreciation purposes (i.e. step-up in value), although a corresponding income is likely to be taxable for the seller. In addition, historical tax liabilities generally remain with the company and are not transferred with the assets. If the company holding the assets (or group company) has tax loss carryforwards, a gain following the transfer of assets may be utilised against the tax losses.

There are no statutory rules on how the purchase price should be allocated among the purchased assets, although it is recommended that the total consideration be apportioned among the assets acquired to the greatest extent possible. The remaining part of the consideration that cannot be allocated is booked as goodwill for the acquirer.

Normal VAT rules apply in an asset deal. However, if all assets of the company (or an independent part of a business) are transferred the rule for transfer of a business as a going concern may apply, which has the effect that no VAT is due at all on the assets sold even if the assets would have been subject to VAT if sold separately.

Regarding the sale of real estate, stamp duty is levied on the higher of the market value and the tax assessment value (the normal stamp duty rate for legal entities is 4.25 per cent).

## 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?

There are no specific strategies to step up the value of the tangible and intangible assets in case of share deals. One must carry out a case by case strategy.

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

Goodwill paid for a business in an asset deal may be depreciated. The rules for depreciation of goodwill are the same as those for machinery and equipment.

The two main depreciation methods are the declining-balance method, where a maximum depreciation allowance of 30 per cent of the aggregated book value is allowed, and the straight-line method, where assets are depreciated by 20 per cent annually.

Most tangible and intangible assets may be depreciated for tax purposes under the same rules as machinery and equipment. However, land and shares etc. are non-depreciable.

Buildings are depreciated straight-line by approximately two per cent to five per cent annually, depending on the nature of the building.

## 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?

Sweden's introduction of interest deduction limitation rules came into force as of 1 January 2009, as a reaction to an extensive use of debt push down-structures under the old, quite liberal rules. The new rules were intended to target excessive debt financing, tax base erosion and abusive arrangements through intra group restructurings. After criticism and monitoring of the 2009 rules by the STA the rules underwent amendments in 2013, making them more restrictive.

Interest payments to affiliated companies are generally not deductible even if at arm's length. Interest payments may, however, be deductible if that company can demonstrate that the corresponding interest income for the lender would have been taxed at a rate of at least 10 per cent in the hands of the beneficial owner of the interest income ("the 10 per cent rule"). Other income, losses or deductible expenses from normal activities shall not be included when assessing the taxation level.

The 10 per cent rule is not applicable and thus interest not deductible if the primary reason for the debt financing is to achieve a significant tax benefit within the affiliated group. This threshold is set at 75 per cent, meaning that a 24 per cent business motivated transaction will not be accepted.

The right of deduction also applies (regardless of the taxation level of the final recipient) provided the debt relationship is deemed mainly business motivated ("the business purpose rule"). This, however, applies only if the beneficial owner of the interest income is located within the EEA or a treaty jurisdiction.

See proposed changes under question 1 above.

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

A debt push down normally aims to transfer debt to subsidiaries in order to shelter taxable income in the subsidiary and to transfer taxable income through interest.

A debt push-down may be achieved through a dividend distribution from the target or through a transfer of assets between the target company and an affiliated company; both financed by debt provided by an affiliated company or third party.

A third alternative is to use a Swedish SPV to acquire a Swedish target in order to push down debt for the acquisition. The SPV is normally financed by debt from a foreign group company. The profit from the target company may be offset against the SPV's funding cost under the Swedish group contribution rules. Alternatively, the target may be merged with the SPV.

Since deductibility of interest paid to an affiliated party is restricted, any debt structure has to be evaluated in detail.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Individuals are allowed a 50 per cent deduction on the invested amount in a non-listed company (listing refers to listing on regulated markets). The investment deductions may be granted for up to SEK 1.3 million per year. Several requirements, on both the individual and company in question, must be met in order to be granted the deduction.

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

Losses incurred by companies are determined on a continuous basis for each tax period and are deductible from taxable profits for the following tax period. If the taxable profits are insufficient to cover the losses from the previous year, the excess loss is carried forward to the next year (loss carryforward). Losses may be carried forward indefinitely, i.e. without any time limit. However, losses must be deducted from profits as soon as a profit is available.

A company with a loss carryforward can be transferred to a third party, whereby the loss can still be utilized by the company having the loss and also within the acquiring third party group. However, a change of ownership of a company with loss carryforwards will trigger two limitations in relation to the losses, namely

**1)** the amount of loss carryforward that will survive (the amount limitation), and

**2)** the right to deduct loss carryforward against group contributions from companies within the acquiring group (“group contribution limitation)

It should be noted that the limitations only apply to tax loss carryforwards. Thus, a tax loss incurred during the year in which the change in ownership takes place is not affected by these rules.

A “change in ownership” occurs if a company acquires the decisive influence (more than 50 per cent of the votes) over a company with loss carryforwards. The same applies if a company with loss carryforwards acquires the decisive influence over another company.

The maximum loss carryforward that will survive a change of ownership is calculated as 200 per cent of the acquisition cost to receive the decisive influence of the company (less certain capital contributions received by the company with losses). In other words, loss carryforwards in excess of 200 per cent of the acquisition cost will be forfeited.

Swedish tax law contains provisions shifting taxable income between affiliated resident companies, known as group contributions. Any tax loss carryforward that survives the amount limitation is restricted for 5 years following the year in which the change of control took place. This means that during this period, the acquired company may not offset those losses against profits in any company belonging to the buyer’s group. However, where the company itself generates a profit after the change of control, the company may offset its tax losses against those profits (a merger might however restrict even this).

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

There are generally no items specific to Sweden that should be included in the scope of a tax due diligence. Hence, items that should be included in the scope follow from the scope of a due diligence in general.

It should be noted that a reassessment by the STA - to the taxpayer’s disadvantage - cannot be made after the year-end of the year after the fiscal year. The fiscal year corresponds to the financial year.

The Tax Agency can however make a reassessment to the taxpayer’s disadvantage up and until the end of the sixth year after the fiscal year, provided that;

**1)** the taxpayer has submitted incorrect or incomplete information in his tax return

**2)** the taxpayer has been assessed a reduced amount of tax or no tax at all

**3)** the reduced taxation has been caused by the taxpayer issuing incorrect or incomplete information in the tax return; and

**4)** the amount of non-levied tax is substantial.

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

No.

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

Costs attributable to acquiring and retaining income are tax deductible for Swedish corporate tax purposes. In an asset deal, the transaction costs are normally tax deductible.

In case of a share deal, it must be analysed if the transaction costs are in principle related to the acquisition of shares. The costs directly related to the acquired shares are usually capitalised on the shares (and consequently not tax deductible since Sweden applies a participating holding regime meaning that profits /losses on shares are not taxable/deductible).

Acquisition costs will from a transfer pricing perspective only be deductible if the entity that incurred the costs has benefitted from the services provided.

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

For asset deals see question 3. In a share deal, no VAT is due since transactions involving shares are VAT exempt in Sweden. When a business is acquired through a share deal the scope of VAT deductibility on transaction costs for the buyer of the shares depends on whether the acquisition of the company will generate additional revenues that are subject to VAT for the buyer (normally management services or similar services). If on the other hand the acquisition of the shares is a passive investment, no VAT deduction will be given on the transactions costs for the buyer. The distinction between an "active and passive" holding company is strictly applied in Sweden.

It should also be emphasized that certain buying entities (e.g. investment funds and similar investment companies) may have difficulties to claim a full VAT deduction on operating expenses even if a management fee structure is put in place.

VAT on costs for acquiring shares in a company is generally deductible provided that the acquirer intends to actively manage the acquired company; e.g. by supplying management services that are invoiced regularly to the acquired company.

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

**Permanent establishment**

Acquisition of a business in Sweden may give rise to a permanent establishment (PE) in Sweden. The PE definition in Swedish domestic legislation follows the OECD model. In general, three requirements need to be met to create a PE.

**1)** There must be a "place of business"

**2)** The place must be "fixed"; and

**3)** The “business activities” must be carried out through the fixed place

A PE is also present if a person is acting on behalf of a foreign company and has and habitually exercises in Sweden an authority to conclude contracts in the name of the foreign company. A PE will however not be present if the business in Sweden is carried out through an “independent agent”.

Dividends and capital gains attributed to a PE in Sweden may be tax exempt under the participation exemption regime (see Q.18 below).

**Withholding tax**

Withholding tax (WHT) at a rate of 30 per cent is generally imposed on all dividend distributions from a Swedish company to its foreign shareholders. In accordance with the EU Parent-Subsidiary Directive, Sweden does however not impose WHT on dividends distributed to a company that is covered by the directive. The exception from WHT applies provided that the shareholding of the foreign company exceeds at least 10 percent of the capital, without any time requirements. The distributing company and the shareholder should furthermore be one of the specific qualifying types of company listed in the directive.

There is an additional Swedish exemption which applies even if the requirements in the directive are not met, provided the following requirements, inter alia, are met

- The person receiving the dividend must be classified as a foreign company. A foreign company is defined as a foreign legal person that is taxed in its state of residence and the taxation in that state is similar to the taxation in Sweden, or a foreign legal person resident and subject to corporate tax in a state with which Sweden has entered into a tax treaty.
- The foreign company must be equivalent to a Swedish limited company. A foreign company qualifies if subject to income tax where it is resident and provided the shareholders have a limited responsibility for the company’s liabilities and finally that the shareholders may not freely dispose of the company’s assets.
- The share in the Swedish company that distributes the dividend must be a capital asset (i.e. not a trading asset). If the Swedish company is listed, the shareholder’s voting rights must be at least 10 per cent for a consecutive period of 12 months prior to the distribution of dividends in order to apply the exemption.

Finally, WHT may be reduced partly or in full under tax treaties.

**Limitations in deduction of interest expenses**

The limitations of deduction on interest expenses paid to affiliated companies should also be considered (see Q. 6).

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

After an acquisition a group may reorganise in a tax-neutral environment. Tax neutral mergers, de-mergers and transfer of assets are commonly utilised as pre or post-acquisition measures.

In principle, Swedish tax law follows the applicable EU directive on mergers and demergers. Tax-neutral mergers are generally possible provided the transferring company was subject to tax in Sweden immediately before the merger and the acquiring company is subject to tax on the business activity on which the transferring company was subject to tax. A foreign company resident in another Member State always qualifies for a merger or a de-merger, if it fulfils the requirements of the Merger Directive. In order to qualify for tax exemption in Sweden there are however some additional criteria which have to be fulfilled.

In case law, downstream mergers (i.e. a subsidiary absorbing its parent company) have also been treated as tax-neutral.

It should be noted that completing a merger, tax-neutral or not, may trigger limitations on tax loss carryforwards, whereby the existing losses may be forfeited or ring-fenced.

It is possible to transfer assets at a price below fair market value without triggering exit tax (i.e., taxation based on a deemed fair market value transfer) if certain criteria are fulfilled. For Swedish qualifying companies (or permanent establishments in Sweden) a sale at a price below fair market value may be carried out without tax consequences provided that the following requirements are met:

- if full group contribution possibilities from the seller to the buyer are available the full fiscal year in which the transfer is made, or
- if the assets transferred constitute a "line of business" from a tax perspective.

Furthermore, a qualifying transaction cannot be made to a company with previous year's losses where the company's losses are restricted against group contributions or to a company which has group contribution possibilities with such loss company. Typically, this requirement does not restrict the possibility to make a drop-down to a newly established/acquired off the shelf company.

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

A sale of real estate is in Sweden usually made through the sale of the shares in a real estate company. There are no specific tax issues solely applying to real estate companies. An indirect sale of real estate can according to current rules under certain conditions be made without income tax (applying the participating exemption regime under the standard conditions). A sale of shares is according to current rules not subject to any indirect tax (i.e. stamp duty or transfer tax). A proposal for new rules on taxation of companies holding companies has been presented (see above),

When acquiring a real estate company, a buyer must however consider the complex rules on depreciation of real estate.

In a share deal the buyer will normally require a discount for deferred tax. There are a number of factors that affect how much the discount for deferred taxes will be in the individual case.

If the real estate is sold directly, capital gains are subject to corporate income tax at the normal income tax rate. As for capital losses, there is a restriction regarding the use of capital losses from the sale against ordinary income. Stamp duty is levied on the transfer (the stamp duty for legal entities is 4.25 per cent).

According to present legislation it is possible, under certain conditions, to transfer real estate to a company within the same group below market value without any immediate income tax consequences. Stamp duty is levied on the transfer; however there are possibilities to reduce and postpone the stamp duty.

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

Each company within a group constitutes a separate taxable entity. There is no taxation on the consolidated level of a Swedish group of companies.

However, specific rules permit the transfer of profits between companies within wholly owned domestic groups ("group contributions"), which have the effect that taxation of consolidated income is effectively achievable. Group contributions are tax-deductible for the payer and taxable for the recipient.

An important qualification requirement for group contributions is that the group holds more than 90 per cent of the shares during the entire financial year. Furthermore, the receiving company must be liable for tax in Sweden, or at least the income to which that income corresponds must be liable to tax in Sweden.

The group contribution rules admit transfer of profits between two group companies: a transfer that is deductible for the transferring company and taxable for the receiving company. Such transfers are reflected as year-end accruals in the annual accounts of both companies and are executed by a transfer of funds.

In a cross-border context the group contribution rules are not applicable, (albeit they are applicable to permanent establishments of foreign companies in some circumstances). Instead, the group relief rule (Sw. "koncernavdrag)" is applicable. This provides a way for Swedish parent companies to make use of losses that have occurred in non-resident subsidiaries from other Member States or specific listed jurisdictions. The rules do not allow deductions for losses incurred in sub-subsidiaries. The subsidiary must have been liquidated and that process must have been completed. There is also a requirement that there are no other group companies operating in the local jurisdiction. The subsidiary must also have been owned for the entirety of the tax-year until the liquidation is completed. The amount deducted may not exceed the loss incurred in the last tax-year of the subsidiary, nor the positive result of the parent company using the loss. The rules for calculating the actual loss that may be deducted are rather complicated.

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

Sweden does not have any patent box regime or other specific incentives for intangible assets. However, fixed assets, including acquired intangibles and goodwill, are depreciable for tax purposes at 30 per cent on declining balance or 20 per cent on a straight line, with correspondence to the accounts (see question 5 above).

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

There are no specific rules on transfer of intangibles. However, if intangibles are transferred out of the country for a price below fair market value, the seller would in general be subject to exit taxation as if the assets were sold for fair market value. Even if intangibles are transferred out of Sweden, income related to Swedish functions may nevertheless be taxed in Sweden.

## 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?

**Share deals**

As a general rule, capital gain from a disposal of shares is taxable. Losses may only be offset against taxable gains from sale of shares, including gains made by other group companies (assuming full right to group contributions). However, the gain is not taxable and a loss is non-deductible if the participation exemption regime is applicable.

The participation exemption regime applies if the following relevant requirements are met:

1. The shares must be held by a Swedish company. If the shares are held by a foreign company, the capital gains are not taxed in Sweden unless the foreign entity has a permanent establishment in Sweden to which the capital gain can be attributed. The participation exemption may apply in such case, but only if the foreign company is resident in an EEA jurisdiction and if the company is equivalent to a Swedish company. A foreign company qualifies if subject to income tax where it is resident and provided the shareholders have a limited responsibility for the company's liabilities and finally that the shareholders may not freely dispose of the company's assets
2. The shares must be shares in a Swedish limited company or a foreign equivalent. The participation exemption regime also applies with respect to shares in a Swedish partnership or a partnership resident within an EEA jurisdiction

3. The shares must be defined as capital assets for the shareholder, i.e. may not be trading/ current assets
4. If the shares are listed, the shareholder must hold at least 10 per cent of the voting power and the shares have to be held for a one year term

**Sale of other assets**

Capital gain from the disposals of other capital assets are taxable and a loss deductible for the seller. If the sale relates to real estate, the loss may in some cases only be offset against real estate gains, including such gains made by other group companies (conditional that group contributions are available). A capital gain is – simplified – calculated as the selling price less the tax base or residual value of the assets.

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

There are no such income tax rules in Sweden. Concerning VAT, please see comment under question 3 above.

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

There are generally no substance requirements for holding companies tax resident in Sweden.

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

For mergers see question 15.

Spin-offs through distribution of subsidiary shares are tax neutral, provided inter alia all shares in the subsidiary are distributed, the distribution is pro rata and the parent company is listed. In addition to income tax neutrality, no withholding tax is levied on such a distribution to foreign shareholders.

There are also rules on tax exempt mergers and de-mergers (see above).

Sweden does not presently levy transfer tax on shares, although there is a proposal to levy such a tax on transfers of companies holding real estate in Sweden (see above). It is not clear if and when the proposal will lead to legislation.

When a business is sold through a share deal, any VAT incurred for the seller on the transaction costs is, according to the STA, not recoverable as input VAT for the seller. This being the situation since the sale of shares is a VAT exempt transaction. As already mentioned, however, a recent court case from the SAC has altered this position since, according to SAC, a VAT deduction may be given for the seller in cases where the transaction costs are not included in the sales price of the shares but rather are treated as an overall expense in the hands of the seller. See further question 3 above.

If the business is sold as an asset deal, the concept of a transfer of a going concern may apply which means that any VAT incurred during the sales process by the seller will be deductible under normal VAT rules (e.g. the seller must conduct a VATable business and expenses cannot be subject to any general input VAT restrictions). If individual assets are sold, normal VAT rules apply. If immovable property is sold, the scope of the VAT deduction on the transaction costs depends on how the property has been used under the “voluntary VAT liability” scheme by the seller. If no rental income has been subject to VAT in the hands of the seller, no VAT deduction is granted.

## MANAGEMENT INCENTIVES

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

The participant in a management incentive program is taxed when salary and/or benefits are deemed available. Usually the time when the income will be deemed available corresponds to the time of payment or obtaining the benefit.

A participant that, as a result of the employment, acquires an asset, for example a financial instrument, at a price below fair market value, is subject to tax on employment income equal to the difference between the fair market value and the acquisition price (if any). Social security contributions will also be imposed on the difference between the fair market value and the acquisition price. Any increase in value of the financial instrument after acquisition will be subject to capital income taxation at 30 per cent (however there are other tax brackets on holdings in closely held companies). There is no definition of a financial instrument under the Swedish Income Tax Act. As a general rule, it would be required that an instrument be freely transferable in order to qualify as a financial instrument. Instruments carrying rights according to corporate law, for example the Swedish Companies Act, such as shares, warrants and convertible notes should be deemed financial instruments. Contractual rights, such as synthetic options, would likely not automatically be deemed financial instruments. If the acquisition of a financial instrument is subject to certain restrictions, there may be a risk of a postponed date of acquisition, i.e. due to the restrictions the financial instrument is not considered to have been acquired at day one. The financial instrument would instead be considered acquired when the restrictions lapse. This means that any increase in value prior to the financial instrument being considered acquired will be taxed as employment income.

A participant that, as a result of the employment, obtains a conditional right to acquire an asset in the future will be subject to employment income when this right is exercised. In this situation, it should be noted that the fair market value of the asset at the time the right is exercised serves as the basis for the taxation.

Since 1 January 2018, smaller businesses may provide their employees with incentive programs subject to more beneficial tax rules. Under these new rules, benefits provided to employees under specific option program are not taxable, if several requirements are met.

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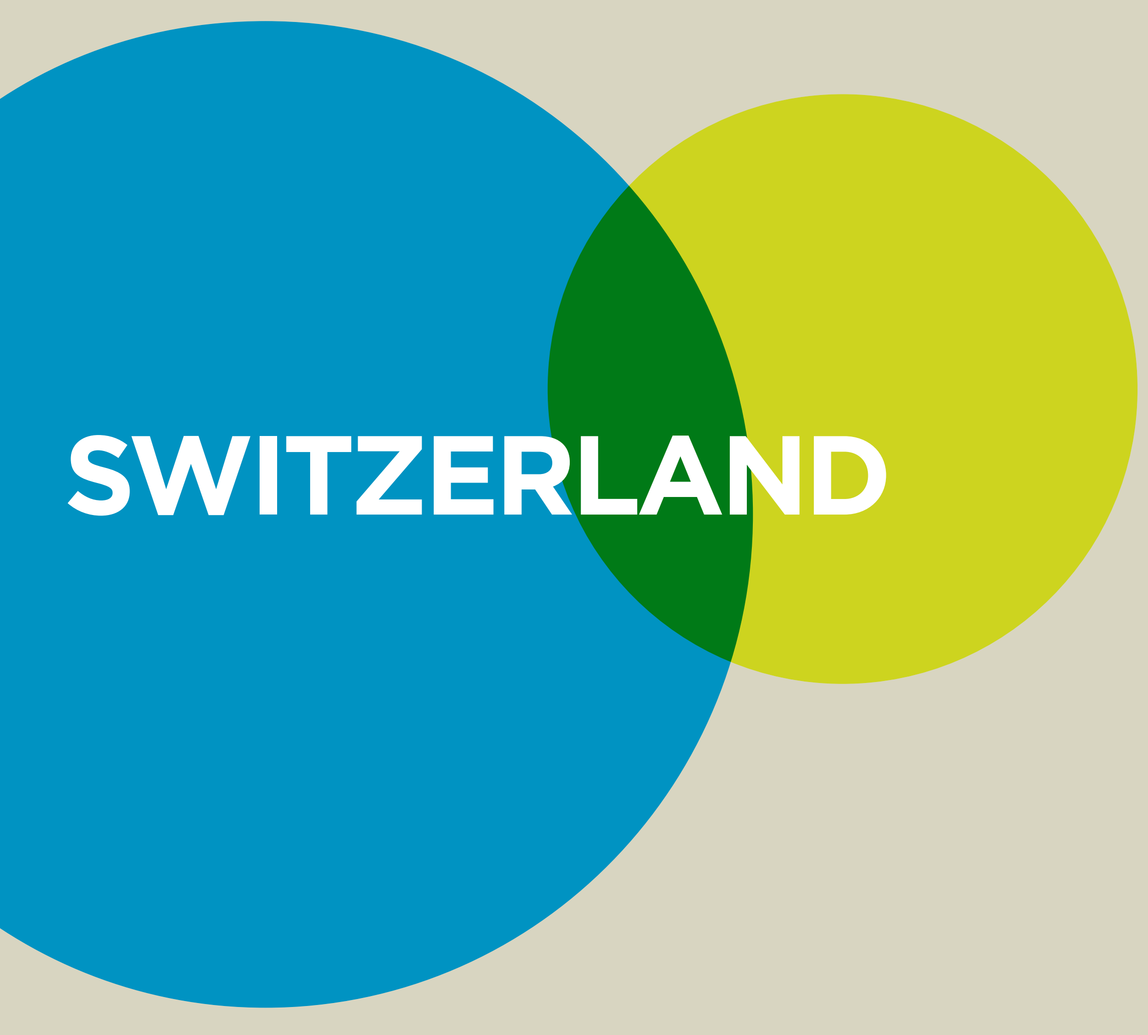

# SWITZERLAND

# SWITZERLAND

## INTERNATIONAL DEVELOPMENTS

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

Swiss tax authorities scrutinize more closely transactions in view of anti-avoidance and anti-abuse rules and in particular the achievement of a tax-free capital gain in a share deal if the seller is an individual and holds his/her shares as part of his/her private wealth.

### 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 DIRECTIVE?

Switzerland implements the minimal standards according to the OECD BEPS Project (i.e. nexus approach for IP boxes, abolishment of harmful tax practice, exchange of information on tax rulings, anti-abuse provisions in double taxation agreements and Country-by-Country-Report) as well as optional recommendations if they are implemented by a large number of countries.

Switzerland introduced into domestic legislation the mandatory minimum standard for a spontaneous exchange of information on tax rulings as per 1 January 2017. The implementation has taken place by way of a revision of the Federal Act on International Administrative Assistance in Tax Matters, together with a revision of the Federal Ordinance on International Administrative Assistance in Tax Matters. The information exchange began a year later on 1 January 2018 and covers tax rulings issued after 1 January 2010, and still be applicable on 1 January 2018 or afterwards.

The legal framework for the implementation of the exchange of the Country-by-Country Report, including the Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) and the respective Federal Act on the International Automatic Exchange of Country-by-Country Reports of Multinationals, entered into force on 1 December 2017. In Switzerland, multinationals with consolidated group revenues of more than CHF 900 million are required to file a CbC report with respect to the fiscal year beginning on or after 1 January 2018 within 12 months after fiscal year end. The first exchange of CbC reports between Switzerland and its partner states will take place during the first half of 2020.

Regarding the minimal standard for Treaty Abuse according to BEPS Action 6, Switzerland supports the principal purposes test (“PPT” rule). Double tax treaties being recently signed by Switzerland already includes the PPT rule in accordance with BEPS Action 6. In the future, Switzerland will implement the new anti-abuse rules either by the new multilateral instrument according to BEPS Action 15 or by a revision of the existing double tax treaties.

Switzerland signed the multilateral instrument according to BEPS Action 15 (BEPS convention) on 7 June 2017. After the consultation taking place until April 2018, the Swiss Federal Council will submit the BEPS convention for approval to the Parliament. With the BEPS convention, Switzerland will implement the BEPS minimum standards only. This includes the preamble of the double taxation agreement in terms of purpose, the application of the PPT rule and the dispute settlement provisions.

## GENERAL

### 3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

**A) Share deal**

**Buy-Side**

The buyer can generally use the target company's carried-forward tax losses in Switzerland, even after the transfer of the target company's shares. The buyer may not be able to offset financing costs against future profits of the target company. No tax consolidation is possible in Switzerland.

**Sell-Side**

**Business assets:** Corporation tax on the sale may be reduced under Switzerland's participation exemption. Losses carried forward in the target company cannot be offset against a capital gain from the sale of the shares.

**Private property:** For individuals holding shares as part of their private wealth, the gain is in general considered as tax free capital gain. In specific cases the tax authorities re-qualify a capital gain as taxable income:

- Securities dealer: If the seller qualifies as a professional securities dealer or - according to the Swiss Supreme Court – he/she regularly and systematically deals with securities – the capital gain is subject to Swiss income tax and social security contributions
- Transformations: The individual sells his/her shares to a company he/she controls
- Indirect partial liquidation: The purchase price is financed with the assets of the acquired company. An indirect partial liquidation will be assumed if shares representing at least 20% of the share capital of a company are sold from the private assets of an individual investor to the business assets of a corporate or an individual buyer, and the target company distributes current assets not needed for business operations out of distributable profits
  or reserves within a period of 5 years after the sale of shares with the cooperation of the seller

The transfer of shares is not subject to Swiss VAT.

**B) Asset deal**

**Buy-Side**

The buyer may be able to amortise the acquired assets tax effectively, including goodwill. The buyer may be able to offset financing costs against future profits of the transferred business. However, the buyer cannot use any losses carried forward by the seller.

**Sell-Side**

Corporation taxes are generally payable on capital gains from the sale of assets. Losses carried forward by the seller can be set off against a capital gain from the sale of the assets. A potential loss from the sale of assets can be offset against profits by the seller.

From a VAT perspective the transfer of assets is basically subject to VAT. Depending on the transaction, the VAT due may be notified to the VAT authorities (i.e. no cash flow).

## 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?

There are no strategies to step up the value of assets in share deals in Switzerland. A step up in the value of tangible and intangible assets leads to a taxable profit.

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

In a share deal, the tax base for the shares in the purchaser's books is equal to the purchase price. Except in exceptional cases (e.g. if the acquired company encounters serious financial difficulties), it is not possible to write off the goodwill component on shares for tax purposes.

As a contrast, in an asset deal the goodwill may be recorded separately and written off against taxable income. In an asset deal goodwill may generally be depreciated over a period of 5 years or longer.

### 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?

Under the federal thin capitalisation guidelines, the minimum capitalisation is calculated based on the maximum indebtedness of all of the assets. For each type of asset only a specified percentage may be financed with debt from related parties (directly or indirectly).

According to the practice of the Swiss Federal Tax Administration, the maximum percentage of debt authorised for each type of asset is as follows:

- Liquidity – 100%
- Receivables on supplies and services – 85%
- Other receivables – 85%
- Stock – 85%
- Other circulating assets – 85%
- Swiss bonds and foreign bonds in Swiss francs (CHF) – 90%
- Foreign bonds in foreign currency – 80%
- Swiss and foreign quoted shares – 60%
- Other shares and investments in limited liability companies – 50%
- Participations – 70%
- Loans – 85%
- Installations, machines, tools, etc. – 50%
- Operating real estate – 70%
- Villas, parts of real estate, vacation houses and building land – 70%
- Other real estate – 80%
- Cost of foundation, increase of capital and organisation – 0%
- Other tangible assets – 70%

The required equity is calculated on the basis of the fair market value of all assets as stated in the balance sheet at the end of the business year. The federal tax authorities publish maximum interest rates on borrowings from related parties annually. For the fiscal year 2018, the maximum interest on loans between related parties denominated in Swiss francs amounted to 3% for business loans up to CHF 1 million respectively 1% for business loans above CHF 1 million. For loans denominated in other currencies the maximum allowed interest rates for the most important currencies are also published by the federal tax authorities: for the fiscal year 2018, the maximal interest rates for loans denominated in US dollars amounted to 3.0% and for loans denominated in Euros amounted to 0.75%. However different interest rates are applicable if the taxpayer can prove that the financing is at arm's length. In this case a tax ruling is recommended.

Should the interest rates not meet the above requirements, the exceeding interest is qualified as deemed dividend distribution and is not deductible for tax reasons. Furthermore, Swiss withholding tax is levied on the deemed dividend distribution.

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

If a Swiss leveraged acquisition vehicle (SPV) purchases the shares of the Swiss target company and the SPV and the target company are then merged, the SPV's debts will be taken up into the operating company. However, the Swiss tax authorities will likely qualify this as an abuse, with the result that the interest paid on debt is not tax-deductible. If the SPV is not merged with the target company, dividends paid out by the target company may serve to finance the acquisition debt (participation exemption could be applied on the dividend distributed). In an acquisition by an operational company followed by a merger of the operational company with the target, Swiss tax authorities in general do not treat such debt push-down as misuse.

However, there is a risk that tax authorities could qualify such a merger in the case where the shares have been purchased from a private individual seller as an indirect partial liquidation, triggering unfavourable tax effects for the seller.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Under the current Swiss tax law, there are no tax incentives for equity financing. In the ongoing parliamentary discussions on the introduction of a tax bill on new corporate taxation ("Tax Proposal 2017") it is evaluated whether a notional interest deduction on surplus equity capital will be introduced as a voluntary measure at cantonal / communal level.

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

The target companies carried-forward tax losses can generally be used within the maximum offset period of 7 years, even after the transfer of the target companies shares. The transfer of ownership in the target company does not generally impact the carried-forward tax loses. In the case of an acquisition of a shell company (a mostly liquidated company holding cash) the tax losses may not be used.

In an asset deal the target company's losses are not available.

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

For Swiss indirect taxes (e.g. Swiss withholding tax, transfer tax, VAT), the statute of limitation is in general 5 years (in the case of tax crimes: 7 years). For Swiss income tax, the Swiss tax authorities issue final tax assessments for each tax year after filing the tax return on a regular basis. If a tax year is finally assessed, in principle no tax audit is possible for this tax year, and the final tax assessment cannot in principle be changed by the Swiss tax authorities any more unless in case of tax evasion or tax fraud.

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

Transfer stamp duty (or security transfer tax) is due if taxable securities are transferred for consideration and if a securities dealer, as defined in the Swiss Federal Stamp Tax Act, is involved, either as a party or as an intermediary. Certain types of transactions or parties are exempt.

Security dealers are banks, actual dealers in securities and, among others, Swiss companies that hold securities with a book value of more than CHF 10 million according to their latest balance sheet. A new company should not be liable for stamp duty until 6 months after the first balance sheet showing taxable securities of at least CHF 10 million.

Taxable securities are in particular shares, bonds and participations in mutual funds. The rate of transfer stamp duty is 0.15% for Swiss securities levied on the consideration. If foreign securities are transferred, the transfer stamp duty is 0.3%. Transfer stamp duty is payable by the securities dealer but usually paid by the parties to the transaction.

No VAT arises on the transfer of shares. VAT incurred on transaction costs in connection with the acquisition or sale of a share quota of more than 10% is basically deductible as input tax.

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

Acquisitions costs are in general tax deductible for the buyer. Such costs are tax deductible for the target company only, if the corresponding costs qualify as services providing added value to the target company, and therefore, may be considered as commercially justified.

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

Basically, VAT incurred on acquisition costs is deductible as input VAT. Restrictions exist for the acquisition of shares below a 10% quota or for the acquisition of assets that are used for VAT exempt activities. In all other cases, the input tax deduction can be claimed.

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

Dividends from a Swiss target company are subject to Swiss withholding tax of 35%. Switzerland has concluded tax treaties with numerous countries which provide a full or at least a partial reduction of the withholding tax on dividends. In addition, for EU countries, Article 9 of the Agreement between the European Union and the Swiss Confederation regarding the automatic exchange of information on financial accounts provides for a 0% rate on dividend payments from a Swiss participation to an EU parent company, if the participation amounts to at least 25% and a holding period of at least 2 years is met.

## 15. CAN THE GROUP REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUPING?

A company reorganisation can qualify as a tax neutral reorganisation. Reorganisations mainly include:

**Legal mergers:** A legal merger qualifies as tax-neutral reorganisation if the assets and liabilities are transferred at book value and the entity continues to be liable to tax in Switzerland. The tax neutrality covers corporation taxes, real estate gains taxes, transfer stamp duty, issue stamp duty and dividend withholding tax. The merger is basically also tax neutral for the shareholders. However, for shareholders holding the shares of the merged entity as their private assets, any cash consideration and increase in nominal value is subject to dividend withholding tax and subject to income tax.

**Spin-offs:** A spin-off is tax neutral if the demerging company carries on at least 2 businesses, one of which is transferred to another company, the book values remain unchanged and the businesses concerned remain subject to taxation in Switzerland.

There is no disposal restriction period imposed on a tax neutral spin-off. Spin-offs of holding, finance, licensing and real estate companies are possible, but these types of companies must meet certain requirements regarding their business activities and employees to qualify as a business.

**Share for share exchanges:** A share for share exchange is tax neutral if a company exchanges its own shares for shares in a different company and immediately after the transaction controls at least 50% of the voting rights in this company. The use of consideration other than its shares does not prevent the transaction from being tax neutral, provided the consideration does not exceed 50% of the value of the total consideration, including the shares.

**Hive-downs:** A company can transfer a trade of business or a fixed asset tax neutrally at book value to a newly established or an existing subsidiary in Switzerland. A disposal restriction period of 5 years applies. A company can transfer participations of at least 20%, tax neutrally at book value, to subsidiaries in Switzerland or abroad without having to observe a disposal restriction period.

**Intra-group transfer of assets:** A company can transfer tax neutrally at book value a participation of at least 20%, a trade or business or a fixed asset to a group company within Switzerland. Group companies are defined as companies that are ultimately controlled by the same entity with at least 50% of the voting rights. A disposal restriction period of 5 years applies both to the asset transferred and the group membership. The transfer is only tax neutral if the acquiring entity is subject to tax in Switzerland.

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

A transfer of shares of a company whose main assets are real estate may be subject to real estate capital gains tax. This is dependent on the canton where the real estate property is located. Depending on the cantonal laws at the location of the property, the transfer of shares may also attract a real estate transfer tax on the property's transaction price (the tax is normally due by the buyer). In general, an economic transfer of real estate property in a sale of shares is deemed taxable if all of the following conditions are met:

- The owner holds real estate property in Switzerland indirectly through a corporation
- The owner transfers major parts of the shares in the real estate corporation (i.e., generally more than 50%) to a new shareholder
- The new shareholder obtains by the acquisition of the shares the economic power of control on the real estate

In international transactions some of the double tax treaties provide for treaty protection for real estate capital gains in share deals with a Swiss real estate corporation.

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

Fiscal unity / tax grouping is not available in Switzerland.

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

With the bill for the new corporate taxation ("Tax Proposal 2017") a mandatory patent box shall be introduced at cantonal / communal level. Under this system, net profits derived from patents and comparable rights will be taxed at a discount of maximum 90%. The term "comparable rights" encompasses supplementary protection certificates, topographies, plant varieties, data protection in accordance with the Therapeutic Products Act, and the corresponding foreign rights. Not included in the patent box are innovations that are not protected by a patent. This measure does not apply to the direct federal tax.

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

A gain due to a transfer of intangibles leads to corporate taxation. Should the remuneration not be at arm's length the difference between fair market value and the remuneration paid is considered as a hidden divided distribution being subject to corporate income tax and withholding tax. Depending on the residence of the beneficiary the withholding tax can be partially or fully be reduced based on the respective double taxation agreement.

# 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 are in general taxed with federal income tax and cantonal or communal income tax for entities and individuals holding the assets as business assets.

Participation relief for entities applies for capital gains derived from the disposal of qualifying participations. However recaptured depreciations on a participation are not subject to participation relief. The requirement to qualify for participation relief is a participation of at least 10% and a holding period of at least 1 year.

Participation exemption does not lead to an exemption of the capital gain from the tax base but is rather a tax abatement mechanism. From the gross participation income, administration costs and financing costs need to be deducted. The percentage of the - net participation income calculated in this way to the total taxable income determines the tax abatement for the participation income.

For individuals holding their assets as part of their private wealth, capital gains are in general not taxable in consideration of certain exemptions.

For individuals holding their assets as business assets a reduction of 40% - 60% is granted on the taxable capital gain for qualifying participations (participation of at least 10% and a holding period of at least 1 year) depending on the canton involved.

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

As mentioned above a sale of assets is basically taxable. Reinvestment of the consideration received in a new fixed asset is an exception to that rule. If the conditions of a reinvestment are met, the taxation is carried over until the future realisation of the new asset.

5 cumulative conditions must be fulfilled:

The replaced asset and the new asset must be fixed assets necessary to the exploitation

The reinvestment must be done within a reasonable period of time. A period of 2 years qualifies and a longer period must be objectively justified

The reinvestment must take place in Switzerland, but not necessarily in the same canton for cantonal tax purposes

The book value of the replaced asset must be kept. This ensures the tax-neutrality of the operation. If the company sells and reinvests the asset during the same tax period, a depreciation of the same amount of the undisclosed reserve must be accounted. If not, a provision of the same amount must be booked. When the new asset is acquired, the provision will be dissolved and used for depreciation. If the company reinvests only after a reasonable period, the provision is dissolved, and the amount is added to the taxable profit.

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

In order to qualify for treaty relief on outbound dividends (reduction of the Swiss withholding tax on dividends), the Swiss Federal Tax Administration (SFTA) developed certain criteria which are to be met. For a foreign holding company, the SFTA requires that the equity capitalization of the direct foreign parent company should be at least 30% of the book value of the participations held. Furthermore, in general, the foreign parent company should hold further investments in addition to the Swiss company and have minimal physical substance at its place of residence (e.g. office, employees, board members with local residence). Ultimately, the SFTA base its judgment on the overall facts and circumstances.

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

A company reorganisation can qualify as a tax neutral reorganization (including for Swiss income tax, VAT and transfer tax purposes). Reorganisations also include:

**Legal mergers:** A legal merger qualifies as tax-neutral reorganisation if the assets and liabilities are transferred at book value and the entity continues to be liable to tax in Switzerland. The tax neutrality covers corporation taxes, real estate gains taxes, transfer stamp duty, issue stamp duty and dividend withholding tax. The merger is basically also tax neutral for the shareholders. However, for shareholders holding the shares of the merged entity as their private assets, any cash consideration and increase in nominal value is subject to dividend withholding tax and subject to income tax.

**Spin-offs:** A spin-off is tax neutral if the demerging company carries on at least 2 businesses, one of which is transferred to another company, the book values remain unchanged and the businesses concerned remain subject to taxation in Switzerland.

There is no disposal restriction period imposed on a tax neutral spin-off. Spin-offs of holding, finance, licensing and real estate companies are possible, but these types of companies must meet certain requirements regarding their business activities and employees to qualify as a business.

# MANAGEMENT INCENTIVES

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

The principle that capital gains are being treated as tax-free is offering great planning opportunities for manager remuneration.

Such capital gains may be realized through the grant of employee shares. In a first instance any benefit upon the grant of shares (positive difference between market and acquisition price) would have to be treated as taxable income subject to income tax and social security contributions. In case the shares are subject to a restriction period, per year of restriction a discount of 6% from the spot may be claimed to define the taxable income (resulting in a maximal discount of 44.161% for a restriction period of 10 or more years). Any capital gain upon the sale of the shares (after the restriction period - if any) would be treated as fax-free irrespective of the holding period of the shares.

This principle that capital gains are treated as tax-free may be derogated in case the shares need to be sold back to the issuing company in the end or in case they have to be sold to a professional investor who is using funds from the target company to finance the share purchase. Thus, the proper tax planning around employee shares needs to include the detailed action procedure not only upon the acquisition of the shares through the manager but also upon the sale of the equity rights unless the shares of a listed company are involved which can be sold on the stock exchange market.

Also, the tax treatment of sweet equity (i.e. disproportional compensation for certain shareholders compared to others) is still offering good planning opportunities. Most cantonal tax authorities claim in these days that any disproportional compensation of a certain group of shareholders (like the management) does result in the situation that the disproportional part of the compensation needs to be treated as taxable income. However, depending on the exact residency places of the management within Switzerland or in case it is possible to structure the sweet equity compensation with subscription rights it is still possible to argue with tax-free capital gains.

Further, for internationally mobile employees it is possible to spread the income from equity plans over the different employment jurisdictions of the plan participant. This principle does always allow some planning when the characteristics like in Switzerland for the interpretation of double taxation treaties is taken into consideration.

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# UNITED KINGDOM

# UNITED KINGDOM

## INTERNATIONAL DEVELOPMENTS

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

The main developments in the UK relevant to M&A transactions are the continued implementation of the BEPS actions into domestic legislation. The UK is generally supportive of the BEPS actions and has already issued legislation. In particular, the UK tax authority has introduced new legislation in the following areas:

- Action 2: Hybrid mismatch legislation took effect from 1 January 2017
- Action 4: Corporate interest deduction - restricting tax deductions available for interest expense based on 30% of the UK group's EBITDA or a group ratio based on actual net third party interest to EBITDA for the worldwide group, which took effect from 1 April 2017
- Action 6 / 15: The UK signed the MLI in June 2017 and introduced draft legislation to implement the modification of bilateral tax treaties to implement tax treaty measures developed as part of the BEPS project
- Corporation tax loss carried forward rules – restricting the amount of carried forward losses which can be offset in the future but providing more flexibility in how losses can be relieved, took effect from 1 April 2017
- Substantial Shareholding Exemption changes – which simplifies the UK capital gains participation exemption requirements and should make it available more widely.

Since 1 April 2017, the UK's corporation tax rate has been 19% and it has been announced that this will decrease to 17% from April 2020. The decrease in the tax rate is expected to be offset with an increase in the tax base by increasing anti-avoidance provisions.

### 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?

The UK government successfully helped initiate the G20-OECD BEPS project, and worked with G20 and OECD partners to bring this to a successful conclusion in October 2015 and deliver the 2015 Final Reports. The UK's objective has been to ensure that profits are taxed where the economic activity generating them takes place.

In 2014, the UK was one of the first countries to implement the OECD country-by-country reporting template, which will improve transparency of business to tax authorities. The UK continues to be one of the leading countries pushing the BEPS agenda and in some cases, has adopted stricter measures than anticipated.

Action 6 lays down requirements for the availability of treaties to be limited to situations where a 'principle purpose test' (PPT), based on the transactions or arrangements, is met. The PPT can be separately supplemented by a 'limitation on benefit's' (LOB) rule which limits treaty benefits to persons who meet certain conditions. The UK will adopt the PPT through the multilateral instrument (MLI) but will not seek to include the supplementary LOB provisions.

Action 15 of the OECD's Base Erosion and Profits Shifting (BEPS) project recommended the development of a multilateral instrument (MLI) to allow countries to swiftly modify their bilateral treaties to implement tax treaty related measures developed as part of the BEPS work. The UK signed the MLI in June 2017 and introduced draft legislation to implement the MLI into UK law.

## GENERAL

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

**A) Share deal**

The purchase of shares means that the purchaser acquires the entire company. This includes all assets and all liabilities including any historical liabilities.

The purchase of shares in the UK results in few immediate tax deductions – there is no form of deductible amortisation on the purchase price of shares and no ability to rollover qualifying gains from the sale of other assets into the shares purchase price.

One advantage of purchasing the shares in a target company is the possible use of losses in the target company against its future profits, subject to anti-avoidance provisions which may arise following a change of ownership.

Stamp duty at a rate of 0.5% of the consideration paid is payable on the acquisition of shares.

The sale of the shares in the target company may qualify as a tax-free disposal – there is an exemption whereby gains (and losses) on the disposal of shareholdings of 10% or more in trading companies or trading groups are exempt from tax, under the "substantial shareholding exemption".

The sale of shares is often more attractive to vendors because there are more reliefs available and lower rates of tax on gains.

UK-resident individual sellers of shares are typically taxed at a rate of 20%. This compares favourably with the highest rate of income tax in the UK, which is currently 45%.

**B) Asset deal**

In asset deals purchasers can choose the assets they want and leave any known or unknown liabilities behind.

There is also greater scope for immediate and future tax deductions. For example, the acquisition of stock and assets that qualify for capital allowances and certain IP would typically qualify for tax deductions. Further, certain assets purchased may qualify for rollover relief so a purchaser can defer other gains into these acquisitions.

There are potentially higher base costs in assets acquired for capital gains tax purposes. Broadly the tax basis of each relevant asset will be the amount paid for it.

However, any accumulated losses would remain with the vendor entity.

The purchase of assets may qualify as a transfer of a going concern and, as such, VAT need not be accounted for on the sale.

However, there are potentially higher stamp duty costs, as stamp duty land tax of up to 4% of the consideration is payable for transactions relating to UK non-residential land or real estate.

An asset deal is often less attractive for vendors than a share deal because of the potential double tax charge for shareholders, as balancing charges and capital gains arising will fall on the disposing company and further tax charges are likely to arise when proceeds are distributed to shareholders.

**C) Pre-sale hive down of trade and assets**

Where a company leaves a group holding assets that have been transferred to it from other group companies on a tax-neutral basis, these assets are deemed to have been disposed of at market value and then re-acquired. This crystallised a capital gain 'de-grouping' charge which in most cases is added to the proceeds for the sale of shares. Where the trade and assets transferred were used for the purposes of the transferor group's trade, the gain on the disposal of shares may be exempted under the substantial shareholdings exemption. The combined

result of this is that the purchaser gets a clean company holding assets which have been re-based to market value and the vendor is exempted from tax on the disposal. It should be noted that this treatment does not apply to certain intangible assets. Any accumulated trade losses would also transfer to the new company.

## 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?

There is generally no ability to step up the value of assets in a share deal. However, this can effectively be achieved by a pre-sale hive down, as described in the previous section.

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

Amortisation arising on the acquisition of all goodwill or customer related intangibles (including those arising from an asset acquisition) is no longer deductible for corporation tax purposes.

Tax-deductible goodwill depreciation is not available on share deals.

### 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?

The UK tax authority may restrict interest deductions on related party debt (e.g. a push-down of acquisition debt) in the UK unless it can be demonstrated that an independent third-party lender would enter into the transaction. To the extent that interest charged on related party lending is deemed to be excessive it will be disallowed for tax purposes. It is possible to obtain an Advance Thin Capitalisation Agreement (ATCA) with the UK tax authority, which would give certainty on the amount of interest that will be deductible. However, this will often include gearing covenants.

In addition, the UK introduced a new regime with effect from 1 April 2017 that restricts the tax deductions that are available for interest expense based on the higher of: (i) 30% of the UK group's tax-EBITDA, or (ii) group ratio based on the actual net third party interest to EBITDA ratio for the worldwide group. This new rule implements BEPS Action 4 recommendations.

UK tax legislation also contains anti-avoidance provisions that can deny interest deductions where the loan is deemed to have been borrowed for unallowable purposes (which broadly mean that the loan was obtained to secure a tax advantage).

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

Typically, from a UK standpoint in order to push down debt on an acquisition, a new UK holding company is established and leveraged to carry out the acquisition so interest on the debt can be relieved against the target company's profits under the UK's group relief provisions. Broadly UK companies can surrender profits and losses within a group providing that a common parent holds at least 75% of the ordinary share capital.

It may also be possible to borrow to finance distributions from the Target company although this would need more careful consideration in respect of anti-avoidance provisions.

### 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

In the UK there are no tax incentives for equity financing an acquisition of a target company.

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

Trade tax losses incurred prior to 1 April 2017 and carried forward should generally be available to be used against future taxable profits of the same trade in the entity which incurred the tax losses.

Trade tax losses incurred after 1 April 2017 may be carried forward and set-off against future taxable profits of different activities within a company and its UK group companies. Following a change in ownership any pre-acquisition carried forward losses (incurred after 1 April 2017) in the acquired company cannot be group relieved against the profits of companies in the acquiring group (i.e. entities which were not part of its pre-acquisition group) for a period of five years.

Where the group's taxable profits exceed £5m, the amount of annual profit that can be relieved by carried forward trade losses will be limited to 50% of the group's profits.

Carried forward trade losses may be forfeited following a change of ownership under UK anti-avoidance rules where there is a change in ownership and either:

- There is a major change in the nature or conduct of the company's trade within a period of 5 years, beginning no later than the change in ownership and no earlier than 3 years before change in ownership; or
- The change of ownership occurs at any time after the scale of the company's activities has become small or negligible and before any significant revival of its trade.

Where the above applies, losses arising before the change in ownership will not be allowed to be offset against profits after the change of ownership.

Change of ownership restrictions also apply to non-trade tax losses.

Targeted anti-avoidance rules also apply to carried forward tax losses.

In the UK losses remain with the corporate entity and do not transfer on a sale of assets.

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

The UK tax legislation is amongst the most complicated in the world and has over the last couple of years undergone significant changes including the adoption of many of the BEPS action points. Therefore, it is advisable to use UK tax specialists when dealing with the acquisition or disposal of a UK tax resident entity. Particular areas that should be considered within the scope of a tax due diligence are the recent corporation tax changes in the UK tax legislation around hybrids and anti-avoidance and the R&D tax relief scheme which is fairly widely available but complex.

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

Stamp duty is generally charged at a rate of 0.5% of the consideration paid to acquire shares. Where shares are transferred within a group of companies, relief may be available depending upon specific ownership requirements. Typically, these requirements hold that the companies must form part of a group in which: (i) are 75% subsidiaries of a common parent, or (ii) have at least a 75% parent-subsidiary relationship.

There should be no significant VAT issues. VAT is not charged on the disposal of shares, although there may be restrictions on the recoverability of VAT on legal and professional costs associated with the share disposal. The VAT registration of the target company may be disrupted by a sale of shares if they are in a VAT group.

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

Costs relating to obtaining loan finance are tax deductible. Relief will generally be available in accordance with the accounting treatment. These costs would include bank arrangement fees, loan arrangement fees and professional fees incurred to secure the finance.

Expenses relating to the acquisition of an investment which are capital in nature are not tax deductible. Generally, expenditure on appraising and investigating investments will be revenue in nature (and deductible) until the time when the 'acquisition process' commences. Expenditure incurred from that point will be capital in nature.

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

In the past, the UK tax authorities took a tough stance on VAT recovery in relation to corporate acquisitions and challenged many taxpayers claiming recovery of VAT on these costs. HMRC published revised guidance (in April 2017) to confirm the position on the recoverability of VAT in light of the CJEU judgment in Larentia+Minerva in July 2015. HMRC appears to generally accept that an active holding company should be entitled to recover VAT incurred when acquiring a new subsidiary, provided that the holding company which receives advisors' services undertakes economic activity that supports the taxable trading services of the business and makes onward supplies (directly or indirectly) of management or similar services to all subsidiaries it acquires.

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

There are few particular issues to consider when a UK company is acquired by a foreign company. This is largely due to:

- The UK not imposing withholding tax on dividend payments
- The absence of non-resident capital gains tax

However, the UK does impose withholding tax on interest payments and for a foreign company to benefit from reduced rates under tax treaties, the lender would need to have beneficial ownership of the interest income. There is a statutory exemption from withholding tax if the debt is listed on a recognised stock exchange.

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

UK tax legislation contains provisions that enable a tax-neutral reorganisation, such as divisionalisation. These include:

- The ability to transfer assets of a trade, together with accumulated losses, within a group without a charge to tax.
- The tax neutral transfer of assets within a group under the chargeable gains regime
- The ability to surrender tax losses within a group (but see above regarding restrictions)
- Tax free share-for-share exchanges, provided certain conditions are met
- Group relief provisions for stamp duty and stamp duty land tax
- Group provisions for reorganisations that take place within a VAT group.

When considering a group reorganisation post-acquisition, care needs to be taken with regard to future de-grouping charges that may apply if the company is sold outside the group within a period of 6 years. There are also stamp duty and stamp duty land tax relief claw back provisions that apply for a period of 3 years.

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

There have been significant recent changes for real estate investors and developers. Enacted and proposed legislation (subject to further consultation) include:

- Non-resident property developers are taxable on all UK development trading profits
- Anti-avoidance provisions for disguised property trading reinforced
- Non-resident property investors will be brought into the charge to UK corporation tax and capital gains tax
- Proposed new rules will apply to indirect disposals of property-rich companies.

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

The UK does not have a fiscal unity or consolidated group tax regime.

The basic UK corporation tax rules operate on a company by company basis and could in some circumstances result in unfair tax consequences for companies within a group. As a result, there are a number of UK tax rules which aim to eliminate or minimise such unfair tax treatments by recognising the existence of groups of companies. For instance, one advantage a group has is group relief which is a mechanism that allows members of a group to share the benefit of certain corporation tax losses. One member of the group can surrender these losses to another member of the group, which can deduct the loss from its total profits, thus reducing the amount of corporation tax payable.

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

The UK Patent Box regime enables companies to apply a lower rate of corporation tax of 10% to relevant profits earned from its patented inventions. To qualify for the Patent Box regime the company must own or exclusively licence-in patents and must have undertaken qualifying development on the patents. A company may also benefit from the Patent Box regime if it uses a manufacturing process that is patented or provides a service using a patented tool.

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

Capital gains realised by companies on the sale of intangible assets is subject to the standard corporation tax rate.

The Diverted Profits Tax aims to ensure that the profits taxed in the UK fully reflect the economic activity in the UK and is consistent with the aims of the OECD's BEPS project. The Diverted Profits Tax is applicable to businesses that enter into arrangements to divert profits that reduce the UK tax base by either designing their activities to avoid creating a permanent establishment in the UK or creating a tax advantage by using transactions or entities that lack economic substance. The Divert Profits Tax imposes a 25% tax plus interest on any diverted profits (compared with the UK's lower corporation tax rate, 19% from April 2017).

## 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 realised by companies is subject to tax at the standard corporation tax rate.

The only participation exemption for capital gains tax for a corporate seller is the substantial shareholding exemption. This exemption applies to the disposal of a shareholding greater than 10%, held for a continuous period of more than 12 months within a period of 6 years prior to disposal. The company being sold must be a trading company or the holding company of a trading group.

Capital gains tax realised by individuals is generally taxed at a rate of 20% unless related to residential property which is at a rate of 28%. Reduced rates may be available if the shares disposed of were structured as an employee incentive scheme.

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

There is a fiscal advantage to reinvesting proceeds from an asset sale. Rollover relief may be claimed if an amount equal to the proceeds from the sale of qualifying assets is reinvested into other qualifying assets within either (i) 12 months prior to the sale or (ii) 3 years following the sale. For this purpose, qualifying assets include freehold land and buildings, as well as plant and machinery. Alternatively, a separate form of relief is available on the acquisition of depreciating assets (e.g. leasehold property), so that the gain can be held over for a maximum of 10 years with potential for further rollover.

Shares are not qualifying business assets for the purposes of rollover relief, so the vendor is not able to match the gain on any sale of shares with the purchase of another asset even if that asset does qualify for rollover relief.

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

The main UK requirement arises where a UK company is paying interest and is claiming a reduced rate under a double tax treaty. Here, to benefit from the treaty the recipient would need to have beneficial ownership of the interest receipt. The UK tax authority takes the view that beneficial ownership should be determined using the "international fiscal meaning", whereby the recipient should 'enjoy the full privilege to directly benefit from the income'. Where the recipient is bound in legal, commercial or practical terms to pass on the income, they will not be the beneficial owner of the income. Although, following implementation of BEPS Action 6, the position is likely to become more onerous.

As the UK does not impose withholding tax on distributions or on a non-resident's capital gain, substance considerations are not usually an issue here.

In 2015 the UK introduced the 'diverted profits tax' which in summary charges tax (at a higher 25% rate) where a company, which is taxable in the UK creates a tax advantage by involving entities or transactions which lack "economic substance", or, a foreign company structures its affairs so as to avoid a UK taxable presence where there is UK based activity.

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

Corporate reconstructions, mergers or de-mergers can often be carried out in a tax efficient manner but the rules are complex and anti-avoidance legislation may apply, particularly where there is an anticipated disposal.

## MANAGEMENT INCENTIVES

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

Generally, amounts received under management incentives schemes are subject to income tax plus national insurance contributions, with the employing company required to withhold the tax. Corporation tax deductions for these amounts are also generally available.

The granting of share options is not usually a taxable event. The income tax charge arises on the exercise of the option, when the individual receives the shares, and is based upon the difference between the market value of the shares and the price paid for the shares. Corporation tax relief may also be available on this gain provided various conditions are met in respect of the shares, mainly:

- They are a class listed on a recognised stock exchange
- They are shares in a company that is not under the control of another company
- They are shares in a company that is under the control of another company but the other company's shares are listed on a recognised stock exchange.

There is a tax advantaged share option scheme for smaller companies, known as the Enterprise Management Incentive (EMI). Under the EMI there is no income tax charge on exercise of the options. Instead there is a capital gains tax charge, at a lower rate than income tax, on the final disposal of the shares.

## FOR MORE INFORMATION CONTACT:

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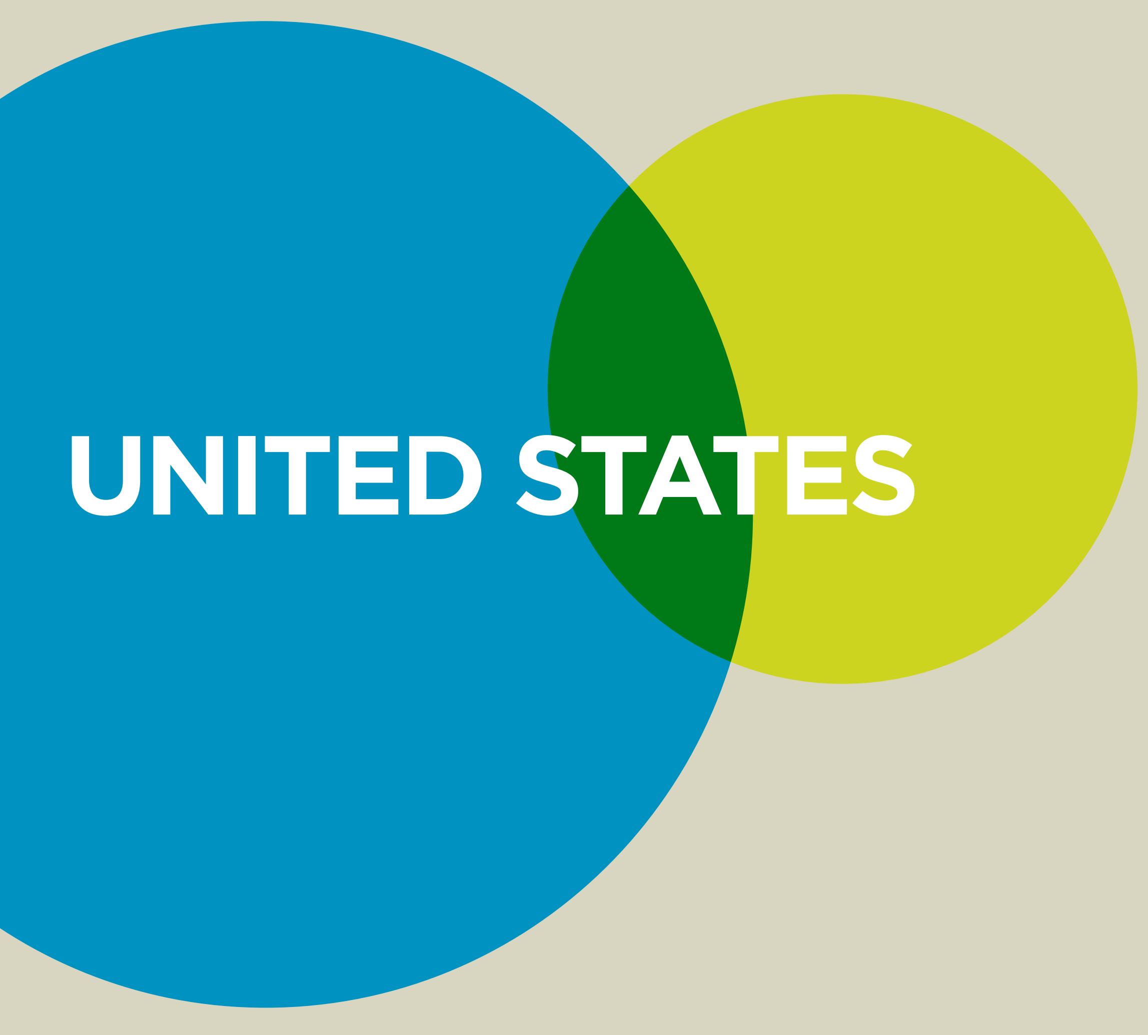
UNITED STATES

# UNITED STATES

## INTERNATIONAL DEVELOPMENTS

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

Comprehensive U.S. tax reform was passed in December 2017. This reduced the federal corporate income tax rate from graduated rates up to 35% to a flat 21% rate. Investors in partnerships and S corporations may receive a 20% deduction for an individual investor's share of qualified taxable income beginning in 2018, subject to certain limitations.

Interest paid by a U.S. entity in excess of 30% of adjusted taxable income (approximately EBITDA) for tax years between 2017 and 2022 is not deductible for tax purposes. For tax years after 2022, a more restrictive definition of adjusted taxable income applies (approximately EBIT). Disallowed interest can be carried forward indefinitely and deducted in a year when current interest expense falls below the limitation.

The international tax rules became even more complex with the passage of tax reform. Deferral of the tax on the earnings of controlled foreign corporations owned by U.S. companies has been further limited by new rules that will generally tax most foreign earnings. Large corporations with at least $500 million in average gross receipts are subject to minimum tax on base eroding payments to foreign related parties. U.S. corporate shareholders who own at least 10% of a foreign corporation are now eligible for a participation exemption for dividends received from the foreign corporation.

### 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.** Plan 6 – For domestic political reasons the United States has not ratified any new income tax treaties in the last several years. Nevertheless, most of the existing US treaties and the US Model Treaty contain Limitation on Benefits articles that are intended to limit misuse. Moreover, unilateral domestic legislation has been enacted that should greatly reduce the incidence of double non-taxation of the worldwide income of domestic enterprises.

**b.** Plan 15 – The United States is unlikely to become a signatory to the Multilateral Instrument.

**c.** EU directives do not apply to the United States.

## GENERAL

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

**a).** A share acquisition generally does not result in the recognition of gain or loss at the entity level. The tax attributes of a company (such as operating loss and credit carryforwards, as well as accounting methods and tax basis in assets) generally survive a share acquisition, although loss and credit carryforwards may be subject to a limitation following an ownership change.

The gain on the sale of stock is generally capital and therefore subject to preferential rates if the seller is an individual. Foreign persons are not generally taxed in the U.S. on gains from the sale of a corporation's stock, except where the corporation is a U.S. real property holding corporation. However, certain disclosure and withholding rules may apply to stock transfers to non-U.S. resident buyers (entities or individuals). Assuming there is no Section 338 election, there would be no step-up in the tax basis of the underlying assets.

**b).** Conversely, an asset acquisition generally results in the recognition of gain or loss by the selling company, as well as at the owner level if the proceeds of sale are distributed. Losses and credits may be used to offset the tax liability resulting from the sale, but do not carry over to the purchaser. The purchaser takes a cost basis (generally fair market value) in the acquired assets.

Historical income tax liabilities of the target business ordinarily do not carry over to the acquirer. These liabilities remain with the seller unless there is a contractual agreement specifically providing otherwise. However, certain non-income tax liabilities (sales and use, payroll, and property) may be inherited by a buyer of the business assets.

A major advantage of a taxable asset purchase is that, in the instance where the seller recognises gain, the buyer receives a corresponding step-up to fair market value in the basis of the acquired assets, generally resulting in increased future depreciation or amortisation deductions for the buyer. Existing tax attributes, such as net operating losses, do not carry over to the purchaser. However, asset sales may result in significant taxes. Many states and local jurisdictions impose sales and use tax on asset transfers, though occasional or isolated sale exemptions often apply. Real property is generally subject to realty transfer or documentary stamp tax.

It should also be noted that asset sales may give rise to both ordinary income and capital gain (taxed at a reduced rate for individuals). In the case of a disposition of a U.S. business by a foreign person, gain is ordinarily treated as effectively connected income subject to U.S. tax. Under recent legislation, the sale of a partnership interest by a foreign person is treated as the sale of that person's share of the U.S. business assets of the partnership.

**c).** If an acquisition takes the form of a "reorganization" in which a substantial part of the consideration is paid in the form of equity of the acquiring company, gain recognized by selling shareholders may be limited to the amount of non-equity consideration received, and gain or loss may not be recognized at the company level with respect to asset transfers. To the extent gain is not recognized, exchanging shareholders receive a carryover basis in the shares they receive, and the basis of the corporation's assets is not increased. A reorganization may take the form either of a stock acquisition or an asset acquisition.

## 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?

Elections are available by which the parties (or in some cases, the seller or buyer unilaterally) may choose to have a share purchase treated as an asset purchase. In that case, selling shareholders will be taxed on the gain on their shares, and the corporation will also be taxed on the gain inherent in its assets. The corporation will be treated thereafter as a newly organized company that purchased its assets. Its tax history and attributes will be eliminated, and it will start over with a fair market value basis in its assets. These elective provisions do not apply to a transaction in which gain is not recognized.

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

Intangible assets (including goodwill) acquired as part of a trade or business are amortised using the straightline method over a 15- year period. Intangible assets not acquired as part of a trade or business are generally amortised using a straight-line basis over their estimated useful lives. Software not acquired as part of a trade or business may be amortised using the straight-line method over three years.

## 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?

Thin Capitalization: Interest paid by a U.S. entity in excess of 30% of adjusted taxable income (approximately EBITDA) for tax years between 2017 and 2022 is not deductible for tax purposes. For tax years after 2022, a more restrictive definition of adjusted taxable income applies (approximately EBIT). Disallowed interest can be carried forward indefinitely.

Debt or equity considerations: Purported indebtedness may be reclassified as equity if the terms of the instrument cause it to resemble equity rather than debt. Interest on debt that is reclassified may be recast as a nondeductible dividend. Whether an instrument is reclassified is highly subjective and fact intensive. Courts rely on several factors, and no one factor is determinative. Here are just a few of the many factors: The intent of the parties and the adherence to formalities, the identity of the creditors and shareholders, the ability of the corporation to obtain funds from outside sources, the thinness of the capital structure, and the risk involved. Additionally, new regulations have been issued that can automatically recast related party debt as stock when the debt is issued by a U.S. corporation to a foreign corporation that is part of the same “expanded group” in a distribution, in exchange for stock, or in exchange for assets in a “reorganisation.” Debt issued close in time to one of these transactions may also be treated as equity if it is deemed to “fund” the transaction.

Transfer pricing: The Internal Revenue Service has the ability under Section 482 to adjust the interest rate on loans between related parties to reflect an “arm’s-length” standard. Interest owed to related foreign persons: In general, interest owed to a related foreign person that is otherwise deductible may not be deducted until it is paid.

AHYDO: If an instrument is classified as an applicable high-yield discount obligation (AHYDO), a portion of the interest deduction is deferred until paid and a portion may be permanently disallowed and treated as a nondeductible dividend. In general, debt issued by a corporation may constitute AHYDO if it: Has a maturity date of more than five years, has a yield to maturity of five percentage points over the “applicable federal rate” (as published by the IRS), and has “significant original issue discount” (an excess of original issue discount accruals over actual interest payments).

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

The primary strategy to push down debt is to form a domestic holding company which, in turn, forms a transitory merger subsidiary used to affect the acquisition. Upon the consummation of the transaction, the merger subsidiary is merged into the target and the proceeds are disbursed to the selling shareholders in exchange for their stock. Financing is arranged for the merger subsidiary, which is subsequently assumed by the target as the successor to the merger. Financing may come directly from third parties or internally through back-to-back loans (subject to conduit financing rules). A US Bidco can also be formed and capitalised with third party or related party debt to acquire the target and then file a consolidated U.S. federal income tax return with the target. As not all states allow consolidated income tax filings, state tax implications must be considered. Other typical strategies to push-down debt, including related party sales or post-acquisition financing, are no longer viable due to the new regulations issued under Section 385.

## 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no tax incentives for equity financing in the United States. Instead, there are tax advantages to debt financing, including the deductibility of interest and ability to distribute cash tax free as a repayment of principal.

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

Prior to tax reform, a net operating loss could be carried back to the two years preceding the loss year and then forward to the subsequent 20 years to offset the taxable income in those years. Net operating losses generated in 2018 and forward cannot be carried back, but may be carried forward indefinitely. Net operating losses that arise after 31 December 2017 cannot offset more than 80% of taxable income in the year to which they are carried.

Where the stock of a corporation is acquired, any net operating losses remain intact and may be used by the acquiring corporation, subject to certain change in control limitations. The most common limitation is imposed by Section 382. Here, where a corporation undergoes an "ownership change," generally defined as a more than 50 percentage point change in its ownership over a three-year period, U.S. tax rules impose an annual limitation, called a "Section 382 limitation," on the amount of taxable income that can be offset by any pre-change net operating loss carryovers and built-in losses.

This limitation equals the product of the value of the loss corporation's equity immediately before the ownership change and the applicable federal long-term tax-exempt interest rate. The limit may be adjusted in certain circumstances which commonly include stuffing transactions and corporate contractions. If the Section 382 limitation for a post change year exceeds the taxable income that is offset by pre-change loss, the Section 382 limitation for the next post-change year is increased by the amount of such excess. Special rules also apply for corporations with built-in gain (or loss) and those in bankruptcy.

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

**Anti-churning:** The anti-churning rules are designed to prevent taxpayers from converting intangibles that existed on or before 10 August 1993, and for which amortisation was not allowed, to amortisable intangibles. The rules apply if the historical shareholders of a business retain an interest of twenty percent or more in a company post-transaction, and the Company commenced operations (and non-amortisable intangibles/ goodwill existed) prior to 10 August 1993. Any goodwill and the related amortisation deductions generated by a transaction would be disallowed if the goodwill was not amortisable under the law in effect prior to 10 August 1993.

**Deferred Revenue:** Generally, advance payments are taxed upon receipt, though there are certain exceptions permitting limited deferral. Under the "Deferral Method," income from an advance payment is recognised in the tax year of receipt to the extent that the taxpayer recognises the payment as revenue in the taxpayer's financial statements for that tax year, with the "deferred" portion of the payment being recognised in the following tax year, regardless of when it is recognised for book purposes.

**State Tax Diligence:** Companies are subject to income and non-income taxes in a state if they have sufficient nexus in that state. There are different types of contact that can generate nexus including economic, clickthrough, affiliate, and physical presence. Where a company has nexus across multiple states, it is important to understand the company's methodology for apportioning activity between states as that determines the amount of income that should be taxed in each state.

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

The sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states may impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

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

Generally, whether acquisition costs are deductible or must be capitalised hinges principally on the point in time at which the costs are incurred. The tax treatment of expenditures incurred in business acquisitions and dispositions is based on a fact-intensive determination of the nature and reason for such expenses.

The general rule requires the taxpayer to capitalise all costs that facilitate a transaction. In general, amounts paid in the process of investigating or otherwise pursuing a transaction are deductible only if the amount relates to activities performed before the "bright line date," generally the date the parties sign a letter of intent or otherwise commit to the transaction.

Costs that are inherently facilitative of the transaction are required to be capitalised regardless of whether they are incurred before or after the bright line date. Costs that are typically classified as inherently facilitative may include costs associated with appraisals, fairness opinions, structuring the transaction, preparation and review of transaction documents, obtaining shareholder approval and property conveyance costs (i.e., transfer taxes and title registration costs).

In addition, taxpayers can elect to treat any success based fees (e.g., banker fees) in accordance with Rev. Proc. 2011-29, which provides a taxpayer with a safe harbor that generally allows for the deduction of 70% of the success based fee (though certain other limitations may apply) and capitalisation of the other 30%.

A certain portion of the costs incurred in a transaction may relate to debt issuance. In general, the costs associated with a borrowing are required to be capitalised and amortised over the term of the debt. When a debt obligation is satisfied, retired, or exchanged the taxpayer may deduct the unamortised debt issuance costs.

Determining the deductibility of transaction costs is a very fact-intensive analysis, especially when dealing with multinational target companies where the transaction costs must be allocated across the different entities and jurisdictions involved. When transaction costs are expected to be significant, we recommend undertaking a formal transaction cost analysis, as this area is consistently challenged by the IRS.

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

There is no VAT, or similar tax, imposed on transaction costs incurred in the U.S.

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

Choice of entity: Foreign investors may choose from several types of entities to invest in the U.S. Partnerships and Limited Liability Companies (LLCs), are generally not subject to income tax but instead are treated as "flowthrough" entities whose income is taxed to their owners. Corporations are subject to tax on their income and their shareholders are subject to tax when the income is distributed to them. Flow-through entities provide the advantage of a single layer of tax (as opposed to the double layer of tax in the corporate regime) and provide a seller a more tax efficient means to convey a step-up in the basis of the underlying assets to a buyer. Importantly, flow-through entities subject their owners to U.S. income tax and filing requirements and, for this reason, many foreign investors prefer to invest in the U.S. through a blocker corporation. Moreover, distributions from flow-through entities may attract branch profits tax, which is a surrogate for the withholding tax that would be imposed on a dividend if the entity were a corporation.

Capitalisation: Investors may capitalise their investment with debt, equity, or a combination of both. Debt may be from an external source or related party. The choice between debt and equity may influence a company's taxable income and its ability to repatriate earnings efficiently. A key differentiating feature is that interest is deductible (subject to certain limitations) whereas dividends are not. Furthermore, repayment of debt is not subject to withholding whereas redemption of equity may be treated as a dividend subject to withholding.

Treaty protection: The U.S. has an extensive treaty network. The ability to choose a favorable jurisdiction from which to invest should be a significant consideration. However, nearly all U.S. treaties contain limitation on benefits provisions that restrict treaty shopping. Inversions: The Inversion rules need to be considered when a U.S. corporation is acquired by a foreign company. These rules can impact the U.S. tax treatment of the foreign acquirer, as well as the recognition of gain or loss related to the transaction. Exit considerations: Capital gains recognised by foreign persons are not generally taxed in the U.S. However, capital gains recognised on the sale of an interest in a partnership engaged in a U.S. trade or business are generally subject to tax, as are gains on United States Real Property Holding Corporations. Other considerations: Where a foreign buyer with a U.S. subsidiary is acquiring a foreign target, consideration should be given to causing the target to be acquired by the foreign parent rather than the subsidiary so as not to create an inefficient “sandwich” structure.

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

A group may be able to reorganise and simplify tax-neutrally after an acquisition through internal tax-free reorganisations, liquidations, mergers, and related transactions. State tax consequences of such transactions should always be considered, as state tax consequences can vary from federal treatment, especially with regard to transactions between members of a U.S. federal consolidated group. Additionally, care should be taken with regard to the impacts of the “step-transaction” doctrine, which courts often apply to integrate a series of otherwise separate steps, resulting in unanticipated and potentially unfavorable tax consequences. Recent U.S. legislation also codified the “economic substance” doctrine. In general, the doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer’s economic position other than a purported reduction in Federal income tax. If a transaction is found to lack economic substance, a strict liability penalty between 20% - 40% of the underpayment of tax attributable to the disallowance of the claimed tax benefit applies.

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

The Foreign Investment in Real Property Tax Act (FIRPTA) taxes nonresident aliens and foreign corporations on disposition of a U.S. Real Property Interest (USRPI), including disposition of an interest in a U.S. Real Property Holding Corporation (USRPHC). A withholding tax of 15% of the amount realised by the foreign transferor must generally be withheld by the seller of a USRPI to ensure that an appropriate amount of tax is paid upon the disposition (higher withholding rates can apply in certain circumstances). The buyer can choose to file a U.S. tax return and report and pay tax on the actual gain realised at standard U.S. tax rates, in which even the withholding tax is creditable as a prepayment of the final tax. A withholding tax also applies to non-resident aliens and foreign corporations that are partners, trust beneficiaries, or estate beneficiaries on the distribution of profits attributable to the sale of a USRPI. In general, a domestic corporation is a USRPHC if the market value of its USRPI constitutes 50% or more of its value. Recent amendments provide exemptions for sales of shares in certain investment entities, and sales by qualified foreign pension funds.

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

U.S. corporations may elect to consolidate their earnings and losses for federal income tax purposes and file consolidated returns where there is an "affiliated group" of entities which are at least 80% related (by vote and value). Losses of one member of a consolidated group can generally be used to offset losses of another member of the consolidated group. A consolidated group can also simplify tax preparation as the number of income tax returns to be filed is reduced. Consolidated (or combined) filings are required in certain states if related entities satisfy certain ownership requirements (ownership requirements vary by state) and are sufficiently interdependent. Other states may permit consolidated (or combined) filings where the entities in the group each have sufficient nexus or connections with that state and make an election. A minority of states do not allow for any form of consolidated (or combined) income tax reporting.

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

No. However, tax credits are available for domestic R&D expenses. For tax years beginning after December 31, 2021, research and experimental costs, including software development costs paid within the United States, cannot be deducted and must be capitalized and amortized over 5 years. Research and experimental costs incurred outside of the United States must also be capitalised, but amortized over 15 years.

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

Cutbound transfers of property are generally taxable. When the property transferred is intangible, special rules may apply to treat the payment as a licence that generates royalty income.

# 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 recognised by individuals are taxed at a preferential rate (currently a 15 - 20% federal rate for the sale of assets held for longer than a year vs. a maximum 39.6% federal rate for "ordinary" type income), while those recognised by corporations are taxed at the corporate rate (currently 21% federal rate). Capital gains are also subject to state income taxes with rates ranging from 0% to approximately 10%. Capital gains recognised by foreign persons are not generally taxed in the U.S. However, capital gains recognised on the sale of an interest in a partnership that is engaged in a U.S. trade or business are generally subject to U.S. tax. U.S. individuals, estates, and trusts may also be subject to the 3.8% net investment income tax. The U.S. does not have a participation exemption regime. In addition, foreign persons are subject to tax on gains from the disposition of a U.S. Real Property Interest under the FIRPTA regime.

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

No. However, deferral may be available if sellers are "rolling over" part of their interest in the business.

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

The U.S. imposes federal income tax on a residence basis, so any holding or finance company established in the U.S. will be subject to corporate level tax in the U.S., regardless of its substance. The eligibility of a U.S. holding company for benefits under a treaty, however, may be dependent upon having either sufficient business activities in the United States or U.S. shareholders.

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

Mergers and spin-offs can be taxable or non-taxable depending on how they are structured and the nature of the consideration paid. For a merger or spin-off to be tax-free, a substantial part of the proprietary interest in the target must be preserved through the proprietary interest in the acquirer, the historical business of the target or a significant part of its historical assets must be used in a continuing business, and the merger cannot have as its principal purpose the evasion or avoidance of federal income tax. Reverse subsidiary mergers and forward subsidiary mergers may also be non-taxable provided these and other requirements are satisfied.

Tax-free spin-offs are possible, though subject to complex tax requirements. A post-spin merger of the transferor corporation will result in a taxable transaction. The rules for spin-offs in practice require a great deal of planning to execute. If a spin-off fails to meet the requirements of a non-taxable transaction, then it may be treated as a taxable dividend.

# MANAGEMENT INCENTIVES

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

There are multiple ways to structure incentive plans for management. The two most common are stock options and profits interests. Companies can also implement cash-based annual incentive plans (AIP), tied to service and execution of the annual budget; issue stock appreciation rights; issue time-based restricted stock/units or performance shares (units)); or payout additional cash compensation based on performance over a multi-year period.

When stock options (as well as restricted stock/units or performance shares (units)) are issued generally there is no taxable event for the issuer or the recipient. When the options are exercised, the difference between the fair value of the shares at the time of exercise and issuance of the stock option is deductible to the issuer as compensation. The holder of the stock option is subject to ordinary income tax on the same amount. Stock options are often exercised and sold (or simply cashed out) at the closing of a transaction, triggering ordinary income tax to the option holders, and a corresponding deduction to the issuer.

Holders of profits interests in partnerships may receive annual allocations of profit or loss from the issuing partnership or a portion of exit proceeds on the sale of the partnership or its assets, once predetermined performance hurdles have been satisfied. This structure can allow profits interests holders to recognise capital gains on exit proceeds in a transaction, rather than ordinary income, which is generally the result in a stock option structure, which would be taxed at higher rates. The partnership, however, does not get a deduction, as could be the case with a stock option structure. Profits interests are commonly used in operating partnerships, as well as where the only asset of the issuing partnership is the stock of a corporate operating subsidiary.

Stock appreciation rights and performance bonuses are taxed as compensation to management as ordinary income and deductible to the company.

Additional points to consider when structuring management incentive plans are as follows:

- Executives may receive accelerated rights to cash incentives, or the vesting of equity compensation because of a transaction. These may be "parachute payments," subjecting the executives to an excise tax, and the payments are not deductible by the seller/target under Section 280G
- For publicly traded companies, compensation greater than USD 1 million paid to executives named in the company's proxy statement is not deductible unless based on pre-established performance goals under Section 162(m). A discretionary payment of incentive compensation in response to an acquisition will likely not be consistent with the original performance goals, and thus some planning or adjustment may be required to preserve the deduction
- Deferred compensation, including deferred incentive compensation, is regulated under Section 409A. Among the regulatory details of that section are specific definitions of a change in control and separation from service that may determine the right and timing to payment, and a rule that requires specified employees to defer receipt of compensation for six months following a separation from service. Target equity awards may be converted into buyer's equity, the method by which this is accomplished may be regulated under Section 409A. Failure to comply with Section 409A can result in early income inclusion, penalties and interest.

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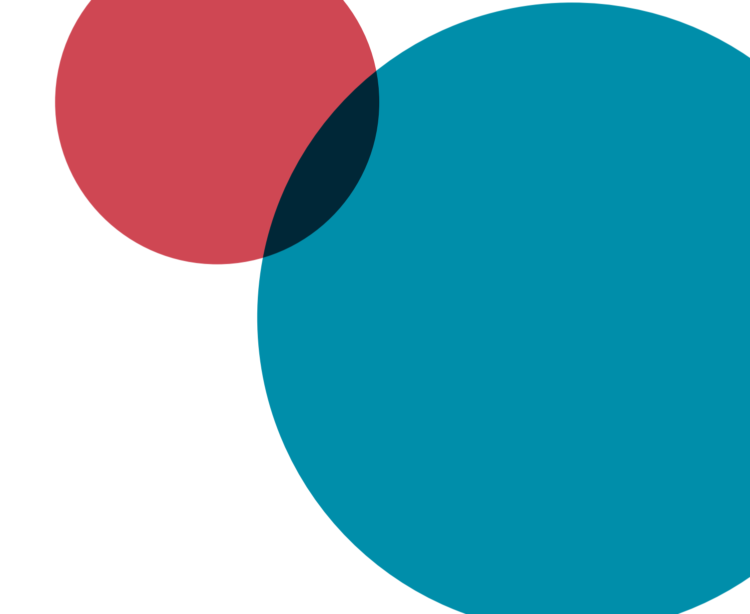

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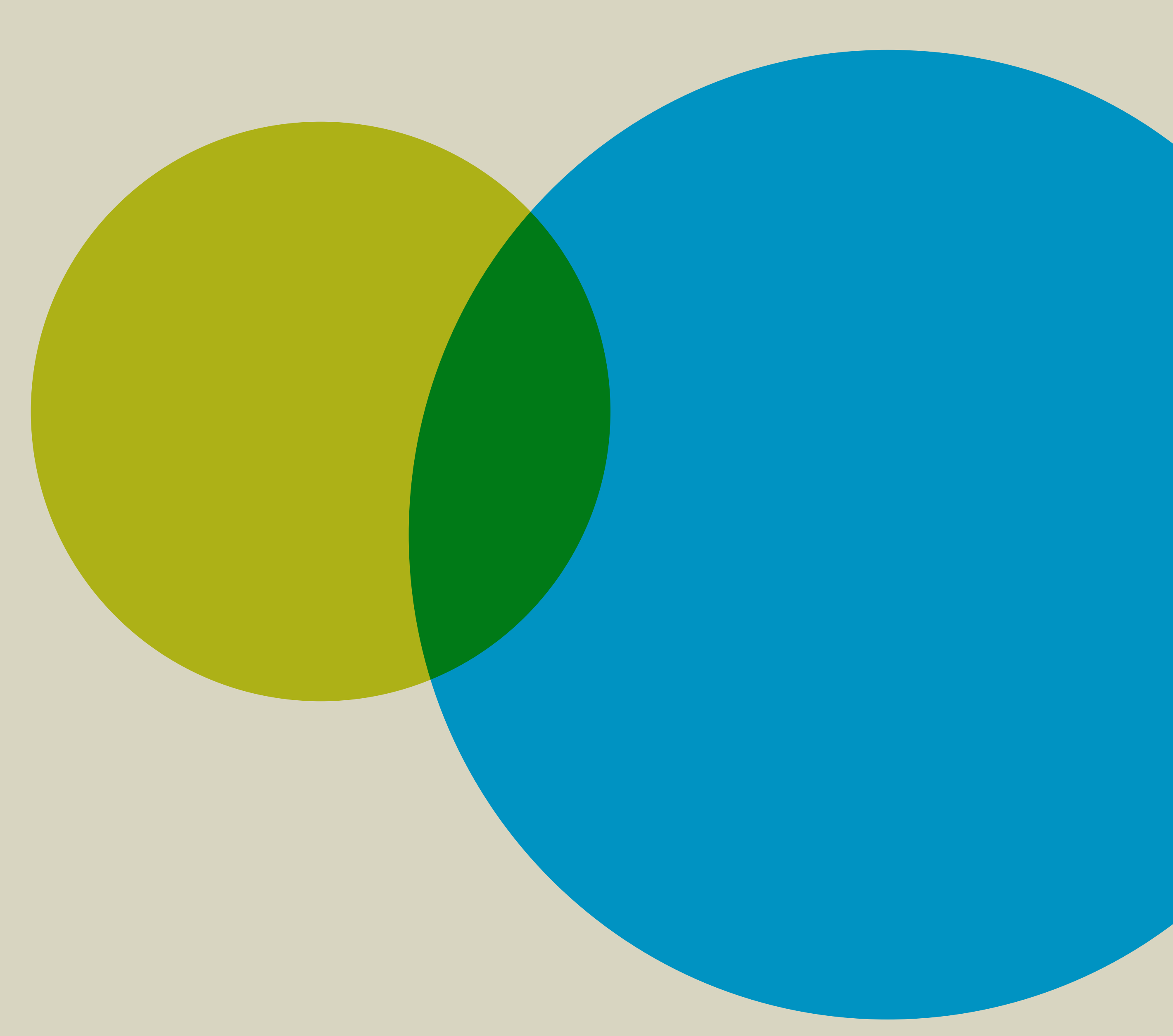

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