

 **TAXAND**

GLOBAL GUIDE TO M&A TAX

**2017
EDITION**

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FOREWORD

2016 was an active year for global mergers and acquisitions (M&A), although by most measures total activity backed off slightly from the records set in 2015. 2017 has begun with deal volumes consistent with early 2016, both in terms of the total number of deals as well as overall volume.

The year saw significant developments in international tax rules, led by the OECD's Base Erosion and Profit Shifting (BEPS) initiatives. There is near unanimous support among governments worldwide for the basic premise of the BEPS programme: that international cooperation is necessary to control the erosion of tax revenues attributable to highly structured transactions. The trend toward narrowing the scope, though not the importance, of M&A tax planning is expected to continue.

Stepping back from short-term market fluctuations, certain truths about the future come into focus. First, business growth, and therefore M&A, will continue to be driven by technological innovation. The pace of development of new and valuable technologies has not slowed. M&A is simply another term for the invisible hand of market economics, which dictate that value will seek out its most profitable avenue of growth as surely as water flows downhill.

Second, and as a corollary, information of all kinds will continue to spread farther and more rapidly than ever in the past. Technology improves communication, and the sharing of information and ideas improves technology. This is a virtuous cycle that has improved the lives and fortunes of billions, and of its own force will continue to do so.

Third, business and industry are not constrained by national borders or parochial regulation. BEPS is one manifestation of this fact. The growing level of cooperation among governments makes it essential for businesses and their advisors to also consider their growth and future profitability from a global perspective.

This edition of the Taxand Global Guide to M&A Tax has been designed as a desktop reference book covering 37 countries. Like its predecessors, it provides at-a-glance insight into the tax treatment of mergers and acquisitions worldwide. It is intended to facilitate interaction within global planning teams by providing a basic introduction to M&A planning in each of the widely diverse fiscal environments in its scope. It is not an encyclopedia, but a phrasebook that should help multinational advisors find common ground and mutual understanding.

National Taxand teams in each of the covered jurisdictions made essential and invaluable contributions to this book. We are grateful for their participation and support in this project. We are pleased to offer this volume as an example of the benefits cross-border cooperation can provide.

Christopher Howe
Managing Director – Alvarez and Marsal Taxand





COMPASS IN THE STORM: M&A IN THE NEW FISCAL CLIMATE

In the world of cross-border M&A, change is everywhere today. This reflects the broader international tax climate, in which national authorities have broken loose from their moorings to longstanding norms and are trimming the sails of a profession attached to traditional practices. Battle rages on multiple fronts: FATCA and the Country-by-Country reporting (“CbC”) movement seek to deny taxpayers the advantage of information privacy, while Base Erosion and Profit Sharing (“BEPS”) and numerous unilateral initiatives undercut the measures historically relied upon to manage worldwide effective tax rates.

The broader economic environment is also in flux, as Brexit and have-versus-have-not tensions ruffle the fabric of the European Union, and the United States appears ready to sail off on a solo voyage into uncharted waters. China is laying claim to its own share of the world’s business and financial leadership, with a number of emerging economies primed to follow in its wake. Meanwhile, stock markets reach record highs, private equity storehouses bulge with dry powder, and M&A professionals pass many a sleepless night, with scarcely any time to wonder what all these new developments could mean for the near and longer term state of global taxation and M&A.

The purpose of this volume is less to predict what may happen in the near future, and more to report on the state of affairs today; in particular, to update our information baseline to reflect developments since the last edition appeared. This information is contained in the following pages, where our national practices provide guidance and a basic understanding of the M&A tax climate in their respective jurisdictions. Ahead of that, though, we want to provide an overview of continuing and emerging trends that reflect, in many cases, a changing international consensus on the allocation of tax burdens; and in other cases, a variety of isolated experiments in new tax policy.

1. WHERE IS UNITED STATES TAX POLICY HEADED?

It is no secret that US tax policy has not yet found a new compass following the change of leadership that resulted from the 2016 national election. The change is all the more disruptive for having been unexpected by many.

One of the actions taken by the new Administration is to require a review of significant tax regulations promulgated over the last year. Some of these are of particular importance to M&A in general and private equity in particular. These are described in the United States section of this book, and include:

- ❖ Regulations that would treat certain debt instruments issued between related corporations as equity rather than debt for tax purposes
- ❖ Modifications to the regulations addressing corporate inversion transactions; and
- ❖ Regulations that require the recognition of income when foreign goodwill and going concern value are transferred by a domestic corporation to a foreign corporation in a transaction otherwise treated as a tax-free reorganisation
- ❖ Review of these regulations is part of a larger project to reduce the burden of government regulation on business. As a result, we may see less new regulation along similar lines in the future under the current Administration

Separate tax reform initiatives have been put forward by the Administration and by the members of the party controlling the Congress. Adoption of any of these plans would profoundly affect many aspects of the economy, including M&A. Their goals include promoting domestic business, especially manufacturing, and improving competitiveness. Significant proposals include:

- ❖ Deep cuts to domestic income tax rates;
- ❖ Adoption of a territorial tax system;



- ❖ Limitations on the deductibility of interest by corporations; and
- ❖ “Border adjustments” that would impose a tax on the value of imports while exempting exports.

At the time this article is being written, there is considerable uncertainty about whether these reforms will be adopted, and if so, when.

2. WHERE IS GLOBAL TAX POLICY HEADED?

Outside the United States, multilateralism has been the watchword in the last year. The most important trends in cross-border taxation have grown out of the OECD BEPS (base erosion and profit shifting) project, with an overall goal of reducing global tax revenue loss due to double non-taxation. The Inclusive Framework on BEPS held its first meeting on June 30, 2016 and its second on January 26, 2017. A total of 94 jurisdictions – more than half from outside the OECD – have now joined the Framework, committing themselves to the BEPS package of 15 Actions and to its consistent implementation. Major recent developments include:

- ❖ Drafting of the Anti-Tax Avoidance Directive by the EU.
- ❖ Widespread adoption of automatic exchange of information agreements between governments, in anticipation of the commencement of country-by-country (CbC) report exchanges beginning in 2017 and 2018. CbC reporting is part of BEPS Action 13, Transfer Pricing and Country-by-Country Reporting.
- ❖ Release of a draft report on Branch Mismatch Structures under BEPS Action 2, Neutralising the Effects of Hybrids Mismatch Arrangements, on August 22, 2016.
- ❖ Issuance of an updated final report on BEPS Action 4, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, on December 22, 2016.

- ❖ Signing of the BEPS Multilateral Instrument (BEPS Action 15), the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, by more than 60 countries, on June 7, 2017. The purpose of this instrument is to create a mechanism for amending numerous bilateral tax treaties to incorporate BEPS principles, without the need to renegotiate each treaty separately.

Thus, dealmakers and tax planners around the world face an ever-tightening fiscal net around the structure and financing of cross-border acquisitions. The era in which each country’s tax authorities kept mostly to themselves is over. An unprecedented era of international cooperation is taking its place, fueled by universal revenue needs and implemented through new information exchange protocols and stringent national and international substantive anti-avoidance rules. Like it or not, the playing field has been redesigned to switch focus from whether income will be taxed, to where.

3. WHERE IS M&A TAX PLANNING HEADED?

International M&A tax planning, always challenging, has become a stiff uphill climb and an obstacle course nearly overnight. Certainly business is not waiting for the tax profession to catch its breath. Economies move at different paces, but we all can see the consistent and growing demand for new investment opportunities. Deals will be done, and all will learn on the job how to cope with new rules and restrictions. This and future editions of this book will demonstrate Taxand’s ongoing commitment to mastering the web of international M&A tax rules, and smoothing the way for businesses and investors to work confidently through them in pursuit of their financial objectives.

Here are some thoughts about changes we may expect in the deal-making process from a tax perspective, growing out of BEPS and related trends:

- ❖ Increased focus on substance. Tax authorities are demanding more substance from companies formed to invest in the stock, debt, or intangibles of related parties. Offshore structures will have to accommodate these demands, or risk being disregarded or denied treaty benefits.



- ❖ Diminished importance of ownership relative to economic contributions in transfer pricing of intangibles. While the United States seems to be standing its ground on the attribution of intangible income to single-purpose licensing companies, other countries are trending toward assigning income to the situs of the economic activity that gave rise to the intangibles.
- ❖ Limitations on interest deductions. The trend toward limiting interest deductions to a percentage of income, and/or to a worldwide group average, will continue. Some such limitation may emerge from the tax reform process in the United States, as various limitations have been proposed in recent years, and a modest limitation may produce revenue to finance other reforms.
- ❖ Worldwide exchange of information between tax authorities. In addition to the exchange of CbC data noted above, information about the ultimate owners of investment entities will be subject to broader disclosure. Spurred by FATCA and know-your-client (“KYC”) legislation, this movement also has the momentum to become an international norm.

Will all these new revenue-raising measures so restrict the return on investment in tax planning that it becomes unnecessary? Not likely. As long as tax planning provides the opportunity to squeeze out even a few basis points of after-tax return, to many it will continue to be worth the investment. And many opportunities will still exist to make money-saving decisions in acquisition and financing structures.

Here are a few practical observations that dealmakers should consider implementing immediately, if they have not done so already:

- ❖ With BEPS a reality and US tax reform on the horizon, tax planning should be included in the acquisition (and disposition) processes at an early stage, to identify opportunities and potential pitfalls arising from these developments.
- ❖ Debt financing and refinancing require more detailed advance planning than in the past, due to BEPS and the spread of national limitations on interest deductions, including the recent US debt/equity regulations.

- ❖ As US tax reform comes into focus, consider the impact of any new proposals on domestic and foreign capital and operating structures. Additionally, consider the potential for reductions in tax rates when modeling investments and negotiating the payment for US tax attributes (step-ups, NOLs, credits, etc.)
- ❖ Include realistic estimates of increased tax compliance costs, including the cost of providing enhanced substance to holding companies and group finance operations, in financial planning models.
- ❖ Educate investors and other stakeholders about the ongoing evolution in international tax requirements, in order to manage expectations and ensure appropriate resources are made available to plan, implement, run, and wind-down or sell, complex tax structures.

No doubt, the historical cat-and-mouse game between taxpayers and tax authorities will continue, as traditional structures are adapted to fit into new rules. Historically it has been our experience that when one door closes, another opens, and we can be confident that will continue to be the case. International cooperation among tax advisers and their clients will be increasingly important as economies and taxation schemes continue to globalise. This guide, already invaluable, should be even more so in the future.

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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 23 September 2013, the Income Tax Law was amended. According to the amended act, sale, exchange or other form of disposition of shares and other securities is subject to a capital gain tax of 15% for Argentine resident individuals and foreign beneficiaries.

However, as of the date hereof many aspects of such tax regulations remain unclear and, pursuant to certain announcements made by Argentine Tax Authorities, they are subject to further rulemaking and interpretation. In this regard, as of today no regulations have been issued regarding the mechanism to pay the Argentine capital gains tax when the sale of shares of an Argentine company exclusively involves non-Argentine parties.

On 22 July 2016, the Act 27.260 (Tax Amnesty Act) was published on the official gazette. Such act established a tax amnesty regime which allowed individuals and companies to disclose assets held as of 22 July 2016. It also established a regularisation regime that allowed individuals and companies to regularise their situation before the Argentine Tax Authorities and several tax amendments.

Among the tax amendments was the abrogation of the 10% withholding tax on dividends declared, whether in cash or in kind – except in fully paid shares (in Spanish, acciones liberadas), in respect of both Argentine individuals and non-Argentine resident shareholders. Another tax amendment was the abrogation of the minimum presumed income tax as of 1 January 2019.

Also, act No. 26.190, as amended by act No. 27.191, sets forth the Renewable Energies Promotional Regime which tends to incentivise 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 established a promotional regime for small, medium and micro companies (PYMES, in Spanish) which also contemplates 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?

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

No significant legislative changes have been adopted to date in direct response to the OECD's work. In relation to BEPS Action 15, Argentina is supposed to amend its existing bilateral tax treaties in the following months of the current year in order to adopt treaty-related measures developed in the course of the BEPS project.

Moreover, Argentina has recently signed treaties to avoid double taxation with Chile, Mexico and United Arab Emirates. Both the treaties with Mexico and the United Arab Emirates are in process of entering into force. These treaties all include a section of limitation of benefits, which establishes a number of conditions for the application of the benefits. 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 principle 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.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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. In addition, the Argentine company cannot apply tax adjustment for inflation.
- ❖ 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 reorganisation.
- ❖ 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 Federal Tax Authority (AFIP as per its acronym in Spanish) is made prior to the transfer of the assets and, if the AFIP does not take any action afterwards, within a certain 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 SA shares or SRL quotas by Argentine companies, Argentine Individuals and/or foreign individuals or companies is subject to income tax (see section 18).
- ❖ 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 reorganisation.



- ❖ 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 for a step-up in the value of the underlying assets in share deals.

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

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

❖ General considerations

There is no special limitation to the deductibility on interest of borrowings between Argentinean parties. In such cases, general rules of expenses deduction apply to the deductibility of interest payments.

General rules of expenses deduction also apply in the case of loans granted by foreign entities. In these cases, thin capitalisation rules may apply.

❖ Thin capitalisation rules

Thin capitalisation rules apply to interest paid to foreign-related banks or financial entities (non-located in a low-tax jurisdiction). Thin capitalisation rules also apply to foreign-related parties when the withholding rate on interest is different than the statutory 35% — this is the case for tax rate reductions under a Double Taxation Treaty (DTT). However most double taxation treaties include a non-discrimination clause under which thin capitalisation rules do not apply to interest payments made to the treaty's other party.

In cases where thin capitalisation rules apply, the total amount of interest-bearing liabilities cannot exceed two times the net worth of the Argentinean borrower at the end of the fiscal period. The portion of interest that exceeds the thin capitalisation rules (if any) is not deductible for income tax purposes and is treated as dividends.

❖ Transfer pricing rules

Argentina's income tax law also provides transfer pricing provisions under which any payment to a non-Argentinean related party made by an Argentinean taxpayer is deductible to the extent that such payment is at arm's length.



Deductions can only be made to the extent that the terms and conditions agreed upon with the related party, deriving in the payment, 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 contain 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 informative 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 (related with the Argentine entities or not) will not be considered adjusted to 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 were designed 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 deductions of loan interests related to the acquisition of shares**

AFIP does not allow Argentinean companies to deduct interest payments of 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 are not subject to income tax and, therefore, such interest is 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 judicial precedents in opposite directions, the subject matter is open to discussion.



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

Usual 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 are not subject to income tax and, therefore, such interest is 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 already taxed at the distributing company's level, following the integration system adopted by Argentina
- 2) Dividends could be subject to the so-called equalisation tax when distributed to shareholders
- 3) Future capital gains arising from the sale of Argentinean shares by Argentinean companies, Argentine individuals and foreign companies or individuals is subject to income tax

In case 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 for such interest deduction 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 reorganisation regime certain requirements must be met. Two of the main requirements hold that both entities should have maintained for at least 12 months before the date of reorganisation the same or related activities and that the continuing entity must maintain the same or related activities as the previous entities for at least 2 years as from the date of the reorganisation. Due to certain precedents of the Federal Supreme Court, the AFIP has recently admitted, 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 complied. Also, if certain conditions are met, the tax-free reorganisation 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.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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

Also, under the scenario of a tax-free reorganisation, 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 reorganisation: 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 before the Argentine tax authority (AFIP General Resolución 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 for substituting the use of 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 of the transfer of the 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 that 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 its 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 provinces of Buenos Aires and Entre Ríos establish a tax on free transmission of assets, including inheritance, legacies, donations, etc. Hence, free transmission of shares could be subject to this tax on said jurisdictions.

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. interests from 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 could 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 sales price would be compensated against a higher acquisition cost.

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 its 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.

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

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 not subject to income tax
- ❖ Argentine entities should pay Personal Asset Tax at a rate of 0.25% on the net worth on behalf of the shareholders (in case the shareholders are foreigners)
- ❖ Transactions performed between related parties must comply with transfer pricing regulations
- ❖ If Argentinean bank accounts are used, tax on debits and credits would apply
- ❖ As of today, no regulations have been issued stipulating the withholding and payment mechanism that the non-resident buyer should follow when the transaction is performed between two foreign companies
- ❖ During the last years Argentina applied strong foreign exchange regulations on the inflow and outflow of funds. However, recent changes have been introduced on this matter by the new government administration

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

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

Argentina's income tax law provides for three different types of tax-free reorganisation procedures: merger, spin-off or transfer within the same economic group. The law sets forth special provisions required to achieve a tax-free reorganisation 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 reorganisation 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 triggers the collapse of the tax-free reorganisation regime and it, therefore, becomes subject to applicable federal and provincial taxes.

For a merger or spin-off to qualify as a tax-free reorganisation 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 reorganisation
- 2) Capital must be maintained at the moment of and after the reorganisation
- 3) The companies must have been conducting the same or related business prior to the date of reorganisation
- 4) The same or related activities of the previous company must be continued for at least two years from the date of the reorganisation
- 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 reorganisation. Exceptions are made in fulfilling related activities prior to the tax-free reorganisation, the requirement of conducting business prior to the tax-free reorganisation and certain capital requirement differences.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The sale of real estate is subject to income tax on net income. The final income tax of Argentine legal entities is calculated at the end of the fiscal year from applying the 35% corporate income tax rate to the result of such particular fiscal year. 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 it has not been allowed to make inflation adjustments for tax purposes. As a consequence, any capital gain from the sale of real estate could be high since the real estate cost is historical. However, 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 both operations 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 to avoid paying capital gain taxes 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) that owns the real property. The applicable tax treatment for each of the referred scenarios 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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

- A) Capital gains obtained by Argentine corporate entities (in general, entities organised 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) derived from the sale, exchange or other disposition of shares are subject to income tax at the rate of 35% on net income. 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 authorisation, in which case an exemption applies. The implementing Decree 2334/2013 introduced a provision stating that the exemption includes income derived from the sale of shares and other securities made through a stock exchange market duly authorised by the CNV. 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 from the sale, exchange or other disposition of shares would be subject to income tax (please note that the abovementioned exemption for shares is not applicable to non-Argentine beneficiaries). Therefore, 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 of 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. When both the seller and the buyer are non-residents, the person liable to pay the tax shall be the buyer of the shares, quotas, equity interests and other securities transferred. However, as of today, no regulations have been issued stipulating the withholding and payment mechanism that the non-resident buyer should follow. Please note that this rates could be reduced in certain scenarios due to the application of a Double Taxation Treaty.



19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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) affect 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 on 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.

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

Foreign holding companies are liable to comply with substance requirements. No specific regulations were issued in Argentina. Analysis is made on the basis of substance over form principle.

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

Please see section 15 above.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

The salaries and remunerations of managers and directors are subject to the general income tax regime. There are no special rules applicable other than those that establish that managers and directors must contribute to the autonomous regime, rather than social security contributions.

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

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?

Exit taxation

From 1 January 2016 onwards, whenever assets (including participations) are transferred from Austria to a foreign country in course of a M&A transaction and Austria consequently loses its taxation right regarding the intrinsic hidden reserves, these hidden reserves are subject to taxation, regardless of a realisation act (i.e. sale).

Nevertheless, it is possible to pay, on application, the tax by installments, if the assets are transferred into an EU-Member state or an EEA-Member state which has signed a comprehensive administrative assistance agreement with Austria.

In respect to fixed assets, the installments are paid over a period of seven years. In respect to current assets, the installments are paid over a period of two years.

Real estate transfer tax (RETT)

RETT is levied on all real estate transactions and furthermore on share deals in real estate companies:

- ❖ The applicable tax rate in the course of asset deals depends on the transaction. In case of a free-of-charge transaction a progressive tax rate applies (0.5%–3.5%), while for transactions in connection with a valuable consideration a flat tax rate of 3.5% applies.
- ❖ Since 2016 the regulations concerning share-deals have been amended. If at least 95% of the shares in a company (= corporation or partnership) that owns Austrian real estate are acquired by a single shareholder or by group members of a CIT group, RETT is triggered in the amount of 0.5%. Apart from that RETT is triggered in the amount of 0.5% if the real estate is owned by a partnership and a 95% change of ownership occurs within five years.

If real estate is transferred in the course of a reorganisation under the Austrian Re-organisation Tax Act (e.g. merger), RETT is at a tax rate of 0.5%.

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?

With regards to certain BEPS actions the following legislative changes have already been made:

- ❖ **Action 2 – Hybrid mismatches:** In January 2011, Austria enacted a provision to avoid double non-taxation with regard to hybrid instruments. Dividends distributed by a foreign subsidiary to the Austrian shareholder are not tax exempt under Austrian law, if they are a tax deductible expense at the level of the subsidiary.
- ❖ **Action 3 – CFC rules:** Austria has no CFC rules, 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 - Limitation for interest deduction:** As of 1 March 2014 interest payments and license fees paid by an Austrian entity to a low taxed foreign affiliated corporation are not tax deductible. Although this regulation should enable Austria to implement the interest limitation rule at a later time, it cannot be excluded that the interest limitation rule will be implemented earlier.

❖ **Action 5 - Transparency and substance; 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).

Recently the double taxation treaty with Liechtenstein, effective since 1 January 2017, has been adapted in order to avoid treaty abuse (BEPS action 6).

❖ **Action 7 - Preventing Permanent Establishment (PE) status:** To counter downsizing of sales structures, the Austrian tax administration views that a commissionaire constitutes a PE for its principal.

❖ **Action 8 - 10 - Aligning TP to value creation:** We expect that the Austrian Transfer Pricing Guidelines issued by the Austrian Ministry of Finance will be amended to reflect the BEPS Actions 8-10. Although respective changes have not yet been made, we observe that tax authorities already apply a BEPS compliant approach in the course of tax audits.

❖ **Action 12 - Mandatory disclosures:** In 2011, horizontal monitoring was implemented on a voluntary basis. Mandatory disclosures are demanded by some politicians, but are not yet implemented.

❖ **Action 13 - CbCR:** On 1 August 2016 the Austrian Transfer Pricing Documentation Act was officially published in the Federal Law Gazette. Therewith it became official that the three-tiered standardised approach to transfer pricing documentation, including Master File, Local File and CbCR, is obligatory in Austria. The requirements for multinational groups will apply to fiscal years starting as of 1 January 2016 if certain thresholds are exceeded.

❖ **Action 14 - Dispute Resolution:** Austria is a member of the EU Arbitration Convention. In relation to non EU countries Austria utilises the respective agreements for mutual administrative assistance to solve qualification or transfer pricing conflicts.

❖ **Action 15 - Multilateral Instrument:** Austria has submitted its position to the OECD regarding BEPS action 15 in January 2017 and will soon start to negotiate with affected States.

With regards to the PSD there have not been any legal changes within the last year. However in order to conduct a relief at source in the course of outbound dividend distributions since 2016 the Austrian Tax Authorities require that the distributing Austrian subsidiary submits the form SS-EUMT (certificate of residence, activity certificate) to the responsible tax office proactively, as proof that all requirements are met by the dividend receiving parent company.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Within a share deal generally all tax attributes are basically maintained. The following tax advantages and tax disadvantages have to be kept in mind:



Tax advantages:

- ❖ Tax loss carry forwards available at the level of the target can be utilised in the future, provided that the “Mantelkauf” provision (purchase of a corporate shell) is not applicable. This is the case, if the company is considered to have lost its identity, which means a cumulative substantial change in the economic structure, the organisational structure and in the ownership of the company. The limitation does not apply if those changes take place in the course of a reorganisation which is intended to preserve jobs.
- ❖ In general, interest resulting from a share deal are deductible. In case the seller was an affiliate company, the interest is not tax deductible. Furthermore interest are not tax deductible if the acquisition was financed through an intra-group loan and the recipient of the interest is subject to low taxation.
- ❖ The transfer of a shareholding is tax-exempt in terms of Austrian VAT.
- ❖ Depending on the structuring RETT could be avoided, as RETT is only due if at least 95% of the shares in a company that owns Austrian real estate are acquired by a single shareholder or by companies which are part of a CIT group.
- ❖ No stamp duty is triggered (if however due to “change-of-control-clauses” new contracts have to be concluded, any stamp duty aspects have to be considered).

Tax disadvantages:

- ❖ The assets book value cannot be stepped up.
- ❖ Goodwill amortisation is not available.

B. Asset deal

In an asset deal all or part of the assets of an enterprise are acquired, thus all assets and contracts must be transferred individually. The following tax advantages and tax disadvantages have to be kept in mind:

Tax advantages:

- ❖ If a business is acquired in the course of an asset deal the acquirer may receive a step-up in the assets’ book value and therefore higher depreciation.
- ❖ Any goodwill can be depreciated over a period of 15 years.
- ❖ Interests resulting from an asset deal are tax deductible.

Tax disadvantages:

- ❖ Although a higher depreciation might be seen favorable from a tax perspective it would reduce the potential for dividend payments and thus might lead to a derogation of the ability to service the acquisition debt (thus reducing the possible leverage).
- ❖ Tax loss carry forwards cannot be transferred to the purchaser.
- ❖ The purchase of assets of a business attracts real estate transfer tax (RETT) and registration fees in case real estate is transferred.
- ❖ The renewal of certain agreements (i.e. lease agreements) and the assignment of receivables and other rights to the new owner may lead to stamp duties, provided that a document within the meaning of the Austrian Stamp Duty Act is executed.



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 general the book values of the assets in the transferred company are not affected by the transfer. However, it might be that following the transfer the company gets a new commercial perspective either by a change of strategy, additional group support or synergy effects within the group of its new shareholder(s). In such a case, the depreciation policy might be revised and as a consequence past impairments might be recaptured. However, please note that such revisions would be taxable. If only the terms of useful life of the assets are extended this would not lead to an immediate step up of book values but would have, due to the extended remaining useful life, a similar effect.

Also, in course of a subsequent reorganisation it might be possible to step up the book values for accounting purposes. The tax book values would however remain at the same level.

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

Goodwill can only be recognised if acquired via an asset deal. The useful life is invariably 15 years (with exceptions for professional service firms). A write-down or write-off due to an impairment test would however result in an immediate tax deduction.

In case of a share deal, no goodwill amortisation is allowed but a tax deduction can be achieved by way of a write-down under certain conditions or in course of liquidation.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Austrian tax law neither provides for strict debt equity ratios nor an earning stripping regime. However, if borrowings are from related parties the loan might be re-characterised to equity which leads to non-tax deductible interest expenses, if the interest is not at arm's length. Additionally, the following restrictions apply:

a) Restriction on interest deduction if interest income is subject to low taxation

As of March 1, 2014 Austria has implemented restrictions on the tax deductibility of interest payments at the level of an Austrian company if the following criteria are fulfilled:

- ❖ interest payments are made to an Austrian corporation or to a comparable foreign corporation; and
- ❖ the recipient of such payments is a direct or indirect affiliated corporation or is under the controlling influence of the same shareholder; and
- ❖ the interest payment is in the hands of the receiving corporation
 - not taxable due to a personal or objective tax exemption,
 - subject to a nominal tax rate of under 10%,
 - subject to an effective tax rate of under 10% due to a specific tax allowance for interest and licence payments,
 - a tax refund to the receiving entity or the shareholders of the receiving entity is granted, resulting in an effective tax burden of below 10%.

The deductibility is however not affected if the effective tax rate is reduced to below 10 % due to tax loss carry forwards or the application of tax grouping. If the receiving corporation is not the beneficial owner, the tax regime applied to the beneficial owner is relevant. In this way, back-to-back financing is covered as well. In case of a



partnership as receiving entity, the tax rate of the corporate shareholders behind the partnership determines the level of taxation.

With regards to BEPS Action 4, it is expected that an appropriate interest limitation rule will be implemented in line with the Anti-Tax Avoidance Directive. Although the existing regulation should enable Austria to implement the interest limitation rule at a later time, it cannot be excluded that the interest limitation rule will be implemented earlier.

b) Restriction on interest deduction for inter-company share-deals

If shares are acquired from an affiliate, any related interest expense is not tax deductible.

From a substance over form perspective application of the non-deductibility rule is extended also to cases where the acquisition is equity financed with funds originating from debt financed capital increases.

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

If the buying corporation acquires a majority interest in an Austrian target company, a tax group may be set up. Group taxation offers the advantage of offsetting profits and losses within the tax group and thus resulting economically in a debt push down.

A (limited) debt push down can be achieved by debt financed dividend distributions made by the target.

The merger route generally is not a viable alternative due to various restrictions in corporate law securing the interest of debtors.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Recently a draft concerning the amendment of the Medium Sised Financing Company Law (Mittelstandsförderungsgesellschaften-Gesetz, MiFIGG 2017) has been disclosed. Medium sised financing companies could be temporarily used to bundle equity capital from different investors in order to invest target-oriented in companies in the early phase or growth phase. Thus the access to equity capital should be easier such companies. The investment in the target companies is limited up to a certain amount and with the size of the equity holding.

In this context the following incentives would be available (however the legislative process remains to be seen):

- ❖ dividends paid by the medium sised financing companies to private investors are tax exempt up to TEUR 15
- ❖ with regards to investments in corporations dividend distributions or any capital gains/losses as well as depreciations or appreciations are tax exempt
- ❖ with regards to investments in partnerships any capital gains/losses as well as depreciations or appreciations are tax exempt

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Tax loss carry forwards cannot be transferred in the course of an asset deal.

In the course of a share deal, tax loss carry forwards generally remain available at the level of the target and can be offset against future profits.

However, such tax loss carry forwards perish, if the target company incurs a substantial change (i.e. of more than 75%) in the economic and organisational structure within a short period of time before or after the change in ownership. Exempted are only changes in the course of restructurings with the aim to retain employment.

Careful tax planning is required also in subsequent reorganisations (i.e. merger, spin-off, etc.) as these can also make tax loss carry forwards disappear.

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 numerous legal transactions, provided that a document within the meaning of the Austrian Stamp Duty Act is executed. Stamp duties are payable after being assessed by the tax authorities, in certain cases after self-assessment. The following written agreements – inter alia – attract stamp duty:

- ❖ lease and rental agreements (1%),
- ❖ assignments of rights, e.g. receivables (0.8%),
- ❖ suretyships (1%).

The limitation period starts with expiration of the year in which the tax obligation arose, but may be extended for one year, if an official act for the enforcement of the tax obligations has occurred during this 5-year period. The limitation period might be extended further, although the maximum limitation period amounts to 10 years.

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

A) Share deal

- ❖ For the time being there is no (share) transfer tax or stamp duty on a share deal in Austria. The EU, however, intends to introduce a financial transaction tax, in which case Austria would levy such tax.
- ❖ From 2016 onwards real estate transfer tax is triggered, if at least 95% of the shares in a company owning real estate located in Austria are acquired by a single shareholder or by two or more companies of the same CIT group. Apart from that real estate transfer tax is triggered if the real estate is owned by a partnership and a 95% change of ownership occurs within five years.
- ❖ Share deals are exempt from VAT.

B) Asset deal

- ❖ The renewal of certain agreements (e.g. rental agreements with landlords) and the assignment of receivables or other rights which are affected in the course of an asset-deal may be subject to stamp duty. Precondition is, that a document within the meaning of the Austrian Stamp Duty Act is executed.
- ❖ The transfer of rights in Austria located real estate or similar rights generally attracts real estate transfer tax and registration fees.
- ❖ In the course of an asset deal each single asset has to be evaluated separately for VAT purposes. Therefore, the VAT is based on the purchase price plus transferred liabilities, less tax-exempt (e.g. accounts receivables, transfer of a partnership interest and of shares in a corporation) or non-taxable items (e.g. passenger cars).

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

Acquisition costs should generally be capitalised to the purchased asset, in a share deal scenario as well as in an asset deal scenario. Recently the Austrian Higher Administrative Court determined in a ruling that buy-side due diligence costs could be treated as part of the acquisition costs of the participation (instead of immediate operating expenses) even if the acquisition of the shares is only intended (e.g. in form of a letter of intent) and the final decision has been concluded after the due diligence process. Only any measures for the preparation of a total indefinite and as the case may be possible future acquisition decision (e.g. market study or analysis concerning the selection out of different alternatives) could qualify as immediate deductible operating expenses.



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

VAT incurred in course of an asset deal should generally be recoverable.

Due to the fact that share deals are basically tax exempt for VAT purposes, the question of input VAT deduction does not arise.

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

As the most efficient structure for a debt push down is the creation of a tax group between the acquirer and the target company, an Austrian tax resident acquisition vehicle might be advantageous. On the other hand it has to be noted that under the condition that treaty protection is available, the sale of an Austrian entity by a foreign holding company does not trigger Austrian capital gains taxation, which would be the case in a domestic scenario.

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

Tax neutral reorganisations can only be carried out under certain conditions. Depending on the reorganisation measure (e.g. merger, spin-off, contribution in kind, etc.) the respective conditions for the application of the Austrian Restructuring Tax Act need to be fulfilled. The predominant ones are that the transferred assets constitute a commercial business in the sense that the assets are not just held for investment purposes and that the transferred assets have a positive fair market value. It has to be observed that tax losses might be jeopardised by such subsequent reorganisation.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

There are no special provisions for real estate companies.

If at least 95% of the shares in a company (= corporation or partnership) that owns Austrian real estate are acquired by a single shareholder or by group members of a CIT group, real estate transfer tax is triggered. Apart from that real estate transfer tax is triggered in the amount of 0.5% if the real estate is owned by a partnership and a 95% change of ownership occurs within five years.

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

Austria has implemented a CIT group taxation regime for corporations. A precondition for group membership is a direct or indirect majority shareholding and the majority of the voting rights in a corporation. Beside domestic corporations, also first-tier subsidiaries resident in an EU member state or in a state that has entered into an extensive administrative assistance agreement with Austria can be included in a tax group if certain conditions are fulfilled. The group must exist for at least three years.

Under the group taxation regime profits or losses of group members are attributed to the group parent for corporate income tax purposes. For foreign group members, only losses (no profits) can temporarily be offset at the level of to the group parent according to the percentage of the stakeholding, but have to be recaptured under certain circumstances in subsequent periods (e.g. foreign tax losses are or may be offset against profits abroad in subsequent years).

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

A) Share deal

For qualified international participations (> 10%, holding period > 1 year, comparable to a domestic corporation) there is an election model allowing a corporate taxpayer to choose between a tax effective and a tax neutral status of the participation.

- ❖ **Tax effective status:** Any capital losses or write downs reduce the company's taxable income. However, it should be spread over seven years. On the other hand capital gains or appreciations increase the company's taxable income immediately.
- ❖ **Tax neutral status:** In that case any expenses resulting from capital losses or write downs are not tax deductible. Correspondingly any income resulting from capital gains or appreciations are not taxable. An exceptional rule is available for actual and final liquidation losses, which can be utilised for tax purposes over seven years under certain conditions.

The election concerning the tax neutral or tax effective treatment of an international participation must be exercised in the year the participation is acquired and can be exercised differently for all international participations. These are one-time options and bind the holding company with regards to this specific investment.

If the seller is an Austrian resident individual the capital gain from the sale of shares is invariably subject to a flat tax rate of 27.5%.

B) Asset deal

If the seller is an Austrian corporation any capital gain is subject to 25% corporate income tax. In case the seller is an Austrian individual resident, the capital gain is generally subject to the progressive standard income tax rate. Please note that a reduced rate might be available if the seller had run the business for more than seven years and retires at the time the business is sold. If the person does not retire it would be eligible to spread the taxation of the capital gain over three years.

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

Rollover relief is not available for corporations or individuals. Special provisions apply for private foundations where rollover relief is available.

20. 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 rather to the beneficial 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 as 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).

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

Reorganisation measures under the Austrian Reorganisation Tax Act can be basically carried out tax neutral with retroactive effect of up to 9 month for CIT purposes. Reorganisation measures are also not taxable for VAT purposes, but retroactivity does not apply for VAT purposes. Therefore appropriate compliance aspects need to be considered.



In case the transferring entity has concluded contracts that include so called “change-of-ownership-clause” any tax consequences would need to be analysed (stamp duty aspects; for VAT purposes especially with regards to renting agreements, as such a regulation could as the case may be trigger a input VAT correction).

Any reorganisation measures in connection with CIT groups have to be analysed carefully in order to avoid any negative tax consequences (e.g. concerning the seamless continuation of a tax group, endangering tax loss carry forwards, etc.).

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

For employee participation programmes (e.g. granting of shares free of charge or shares offered at a reduced price, granting options for the purchase of shares at a reduced price) tax incentives in the form of a tax exemption for income tax purposes with a limited amount if certain conditions are fulfilled. In order to benefit from that tax incentive the shares must be granted to all employees or a certain group of employees (whether managers qualify as such a group of employees needs to be analysed on a case by case basis) and the respective employees must hold the shares for at least 5 years (holding period).

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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?

The “speculation tax” for individual investors, which had been applicable since 1 January 2016, has been abolished as of 1 January 2017. The speculation tax consisted of a taxation at the special rate of 33% of capital gains on listed shares realised by an individual within 6 months following the purchase of the listed shares.

In addition, the standard withholding tax rate for dividend, interest and royalty income has been increased (from 27%) to 30%. For dividend distributions between group companies, this increase in many cases will have no effect due to the Belgian and European withholding tax exemptions between related or group companies.

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?

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” (a 95% tax deduction on qualifying dividends received) is allowed for dividends paid by a company to the extent that such income has been or can be deducted of 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 in case of 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 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 regulation.

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

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

In 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.

However, the Belgian legislation on capital gains on shares realised by corporate taxpayers has changed. As a result, the exemption remains fully applicable to small and medium-sized enterprises (SMEs), but capital gains on shares realised by large companies are now taxed at a rate of 0.412% (see also question n° 15).

Individual sellers in principle also still benefit from an exemption 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 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° 16).

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 may allow to use the existing carried forward losses in the target company to fiscally compensate 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 AMORTISATION OF GOODWILL 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 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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. 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 has been introduced 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.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 is the only real motivation for the merger). The latter condition may jeopardise the possibility 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.

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. It allows companies to deduct a notional charge or fiscal cost (not stated in the accounts) from their tax base that corresponds to a specific percentage of their adjusted equity. The rate of the notional interest is 0.237% for tax year 2018 (or 0.737% in case of a SME).



9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 show an increased interest in transfer pricing topics during tax inspections. Also, new transfer pricing documentation obligations have been introduced in Belgium (Programme Law of 1 July 2016 and published in the Belgian Official Gazette of July 4, 2016). The new rules apply as from tax year 2017. The new Belgian rules are based on international transfer pricing documentation guidelines and more specifically on Action 13 of the OECD's BEPS action plan. The new 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. As a general rule, the transfer of real estate is subject to 12.5% registration duties on the sales price. However the sales price taken into account for determining the registration duties due may not be inferior to the normal market value of the property. The registration duties amount to 10% when the property is located in the Flemish region. However 'new' buildings can be transferred under the VAT regime instead of registration duties, in which case the sale is subject to a 21% VAT levying. This rate is higher than the 12.5% or 10% registration duties rate. But 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; the standard rate amounts to 0.27%). 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 affirmative. 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 concerned input VAT 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 a direct link between the acquisition and the taxpayer's economic activities existed.

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

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 disposes of sufficient substance following the take-over so that it cannot be contested that the company remains a Belgian resident company. 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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; and
- ❖ 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 (10% to 12.5% depending 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° 9).

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 provide the possibility of creating a fiscal unity. 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 optimise the deduction of VAT paid on costs or investments.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains realised by a corporate taxpayer are in principle deemed profit and are therefore taxable at the normal corporate income tax rate of 33.99%. However, capital gains on shares are in principle tax exempt.

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

- ❖ The shares must have been issued by companies subject to a normal tax regime (the taxation condition); and
- ❖ The shares must have been held in full ownership during an uninterrupted period of one year (the holding condition).

The exemption is fully applicable for SMEs, but other 'large' companies fulfilling the two exemption conditions mentioned above are subject to a special tax of 0.412%.

In Belgium, SMEs are defined in the Belgian Company Code. According to this Code, an SME is a company with legal personality, which, for the last and second last completed financial year, does not exceed more than one of the following thresholds:

- ❖ Annual average number of 50 employees;
- ❖ Annual turnover, excluding VAT of EUR 9,000,000.00;
- ❖ Balance sheet total of EUR 4,500,000.00.

For companies affiliated with another company, the employees are added up and the annual turnover and the balance sheet total are determined on a consolidated basis.

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

- ❖ Full exemption of capital gains on shares realised by SMEs if both the taxation condition and the holding condition are met;



- ❖ Taxation at 0.412% of capital gains on shares realised by companies other than SMEs if both the taxation condition and the holding condition are met;
- ❖ Taxation at 25.75% of capital gains on shares when the taxation condition is met, but not the holding condition; and
- ❖ Taxation at the standard corporate income tax rate of 33.99% of capital gains on shares when the taxation condition is not met (regardless of the holding condition).

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.

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

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

For capital gains realised on shares, Belgian tax law does not provide for any specific method to defer or avoid taxation – if at all 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 listed on 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 within a certain period of time (in principle within three years, but extended to five years for reinvestments in buildings, vessels or airplanes).

20. 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 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.

21. 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 predominate 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 concerned options 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). In case 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 favourable 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 favourable 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 favourable 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?

On 16 March 2016, the Brazilian government enacted Law 13,259, which 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, Brazilian Federal Revenue Service (“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).

The main key tax consideration associated with private equity investments in Brazil is the tax benefit available to investments on Brazilian Private Equity Funds (“FIPs”). The most relevant tax advantage in connection with FIPs are the following: (i) the tax-exemption status of their portfolio on income and gains from investments, as taxation is deferred to redemption of shares by the FIP investor; and (ii) provided certain requirements set forth in tax regulations are met, non-Brazilian tax resident investors holding shares in FIPs may also be exempt from income tax upon redemption of FIP’s shares (generally levied at a 15% rate, in this case).

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, few references have been formally made to BEPS in Brazilian tax legislation – e.g. a formal indication of compliance with Action 12 in the proposal of Provisional Measure 685 (revoked by the Congress) and with Action 5 in the reasoning for the issuance of Normative Instructions No. 1,634 and 1,689 regarding the disclosure of the beneficial owner.

Besides that, on April 15, 2016 was published the Legislative Decree No. 105/2016 in the official gasette to implement the 2010 protocol to the OECD Convention. On 1 June 2016, Brazil deposited its instruments of ratification with the OECD, and announced that the OECD Convention will enter into force on 1 October 2016. On 30 August 2016, Brazil’s Federal Revenue Service (“RFB”) announced the enactment of Decree No. 8842/2016, which further implements the OECD Convention.



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 NI No. 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 of 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 the assets directly. 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. 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 labour liabilities of the target remain 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 AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Current tax legislation determines that the goodwill paid on local transactions (involving non-related parties) must be allocated according to IFRS: 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 amortisation 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 that the deal is not carried out between related parties.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 seem necessary for the business activities of the borrower.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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. Others structures may also be feasible 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 1 year can be carried forward indefinitely. 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 reorganisations 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 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 BY FOREIGN COMPANIES?

Please see the answer to question 1 regarding the rules of capital gains involving foreign shareholders.

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

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 1, 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.

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

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

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

On September 14, 2016 was published in the Official Gazette the Normative Instruction RFB No. 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 No. 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).

21. 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 Programmes, 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?

In 2014 Canada released a draft proposal to create a sweeping domestic law anti-treaty shopping rule that would over-ride Canada’s tax treaties: see “Canada to Unilaterally Override Tax Treaties with Proposed New Anti-Treaty-Shopping Rule,” Tax Notes International, March 2014. The events since the release of the draft proposal for a domestic anti-treaty shopping rule indicate that the Canadian government has since decided not to proceed with such a measure, and instead, work within the framework of BEPS, although Canada continues to negotiate specific anti-treaty shopping provisions in tax treaties (e.g. the recent tax treaties with Israel and Taiwan), as well as enacting the “back-to-back” rules referred to in Answer 1, above. In the federal budget of 22 March 2016, the Canadian government announced its intention to proceed with anti-treaty shopping initiatives, which may involve signing the pending OECD multi-lateral instrument, amendments to bilateral treaties, or both.

The Canadian government confirmed in the federal budget of 22 March 2017 that it either has taken or is undertaking the necessary domestic processes to ensure that the Canadian tax system meets all of the minimum standards agreed to under the BEPS project. 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 6 and 15:** Canada intends to sign the multilateral instrument dealing with the abuse of tax treaties at the OECD signing ceremony in Paris later in 2017, and is pursuing the necessary domestic action to achieve and implement this decision.
- ❖ **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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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."

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).

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 AMORTISATION OF GOODWILL 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 amortising goodwill and other business intangibles. Effective 2017, such property will be moved into the existing depreciable property regime that amortises 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 USD1.50 of debt owing to such creditors for every USD1 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 lends 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 USUAL STRATEGIES TO PUSH-DOWN THE 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 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 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 BY FOREIGN COMPANIES?

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 Answer 3(a)), (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. 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.



SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. 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.

21. 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 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, and certain limitations on the division of property between the two corporations are observed.

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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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.

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, 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.

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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?

On 2014, a tax reform was enacted in Chile whose provisions have 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 with Chile.

Among other important reforms that have entered into force are: i) hardened rules regarding thin capitalization; ii) carry-back of tax losses is no longer possible; iii) regarding mergers, the goodwill balance generated in excess of the assets' fair value cannot be used as a deferred tax expense as it used to; 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 CFC rules and viii) the replacement of the Statute of Foreign Investment with a new rule that many view as less favourable.

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?

During the past decades, Chile has continually had an open attitude regarding globalization 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 regarding the issues addressed by BEPS Actions, even before the Actions themselves have been 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) hardened thin capitalization rules which set forth a new way of calculating the borrowing company's equity for 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 make it mandatory for taxpayers to recognize 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 entered into 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 is to be completed 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 (and, in some cases, with past tax losses as well).

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 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 AMORTISATION OF GOODWILL IN YOUR COUNTRY?

When a Chilean company is absorbed by another Chilean company, and the acquisition cost of the absorbed company's shares is 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 amortised when the company is dissolved or ceases to operate for tax purposes.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

As a general rule, interest payments on borrowings can always be deducted from income from 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 payment 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 USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

A procedure commonly used to push down debt is to incorporate a Chilean entity into which both capital and debt are contributed. Such company may then acquire the target company, make a capital contribution in 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 capitalization 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 a 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 valued in an amount that justifies 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 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?

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 become applicable.

Regarding VAT returns, the maximum statute of limitations is 36 months. The Chilean IRS places considerable attention on 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 to determine 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 as 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 BY FOREIGN COMPANIES?

If a foreign company acquires a Chilean entity, it is important to take into account 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 informed 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 27% rate at the level of the local company, calculated annually on the net taxable income accrued.
 - ii)** A withholding tax called “Additional Tax” (“WHT”) 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 Tax Income 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 of which such 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 REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

Yes, but in connection with operations 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 produces the transfer of assets from one taxpayer to another, provided that such value is noticeably lower than the market price of the assets being transferred.



However, as an exception to the above rule, the Chilean IRS cannot challenge the value agreed upon when assets are contributed by one entity to another within a corporate restructuring process, provided that the following conditions are met: (i) The restructuring process must meet a criterion known as “legitimate business purpose”; broadly speaking, this means that it must be beneficial from an economic point of view and not carried out solely because of its tax benefits; (ii) The company making the contribution of assets to another company must not cease to exist as a result of the restructuring process; (iii) The assets transferred must be contributed as capital to the company receiving them, and this company’s capital must be increased as a result; (iv) The company contributing the assets must not receive an actual sum of money as a result of its contribution; and (v) The assets must be transferred and registered by the transferee at the same tax basis or book value at which they were recorded in the transferor’s accounting records, and this tax basis or book value must be shown in the Shareholders’ resolution or public deed by which the assets were contributed to the company receiving them.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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

In addition, pursuant to several tax treaties entered into by Chile, the sale of a company whose assets are real estate 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?

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

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.

The former sole First Category Income Tax (“FCIT”) 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) Sales before one year from acquisition: FCIT and Global Complementary Tax (“GCT”), in the case of Chilean resident individuals; or Additional Withholding Tax (“AWT”), in the case of taxpayers resident abroad, on a cash or accrual basis, as chosen by the taxpayer.
- b) Sales after one year from acquisition: GCT/AWT on a cash or accrual basis, as chosen by the taxpayer.
- c) Losses derived from other transactions of the same kind in the same year may be deducted.
- d) Only accumulated attributable profits obtained by the entity being transferred are considered as part of the cost, not those attributed by third parties.

- e) 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 FCIT does no longer apply, so capital gains will always be considered as 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 Treats (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 in 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 alienation, owned shares or other rights representing, directly or indirectly, less than 20% of the capital of that company; and
- ii) The value of the shares does not derive in more than 50%, directly or indirectly, from immovable property situated in Chile.

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

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

20. 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 Additional Withholding Tax (hereinafter “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 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 Additional 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 residents of treaty countries will always be subject to an effective tax burden on 35%.

21. 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

As a general rule, managers' remunerations are deemed as ordinary income and are 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 management members. 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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CHINA



CHINA

INTERNATIONAL DEVELOPMENTS

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

A couple of tax circulars have been released by the State Administration of Taxation (“SAT”) aiming to tackle with various conceptual and practical issues arising with the implementation of the Notice on Several Issues Relating to Treatment of Corporate Income Tax Pertaining to Enterprise Restructurings (Cai Shui [2009] No. 59, “Circular 59”) and the Notice on Strengthening the Administration of Enterprise Income Tax on Share Transfer Gains Derived by Non-resident Enterprises (Guoshuihan [2009] No. 698, “Circular 698”) in 2009.

Circular 698 is known for its significant impact on the deal structure involving the so-called “indirect transfer” of a Chinese entity(-ies). Circular 698 in principle adopts the “reasonable commercial purposes” criteria in the assessment of share transfer transactions. The SAT released a supplemental tax circular, Announcement on Several Issues Relating to Enterprise Income Tax on Transfer of Assets between Non-resident Enterprises (SAT [2015] No. 7, “Circular 7”), which provides a much more extensive scope of ‘taxable properties’ which are potentially subject to the indirect transfer assessment to also include certain assets and real properties, as well as further elaboration on the assessment criteria of “reasonable commercial purposes”. Circular 7 also provides “safe harbor rules” and a new reporting and tax withholding mechanism.

Also issued in 2009, Circular 59 has been acting as the pillar of the enterprise reorganisation tax system. The SAT issued several tax circulars which provide more specific guidance on certain topics addressed in Circular 59, primarily:

- ❖ Circular on Corporate Income Tax Treatments to Encourage Corporate Restructuring (Caishui [2014] No.109, “Circular 109”), which lowers the threshold to enjoy the special restructuring treatment in a share or asset acquisition with respect to the ratio limit, and provides additional circumstances which can enjoy the special restructuring treatment.
- ❖ Announcement of Several Issues Relating to Administration of Levying and Collection of Enterprise Income Tax on Restructuring of Enterprises (SAT Announcement 2015 No. 48), which provides more detailed guidance from implementation perspectives.

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?

China has been actively participating in the BEPS project as a G20 member and a cooperative partner of OECD. Shortly after the OECD released the final package, on 10 October 2015 the State Administration of Taxation (“SAT”) published via its official website the Chinese translation of the BEPS 2015 Final Reports, showing a strong urge of the Chinese government to keep up with the development of international tax system. The SAT also addressed a general plan of actions including but not limited to refining the prevailing tax legislative framework to incorporate the BEPS actions with consideration of practical situation, building up risk management mechanism, etc. Regarding action Plans 6 and 15, it is foreseen that China will implement LOB and PPT clause in its treaties and China will sign the Multilateral Instrument. Also, effective from 1 May 2017, the SAT Notice [2017] No. 6 has addressed the detailed new clarifications on Tax Bureau’s review/approval approaches to the nature and content of the intercompany charges between China entity and overseas related party. It is foreseeable that the BEPS project will have profound influence on the Chinese international tax system in the next few years.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

The seller to the transaction would be the holding company of the Chinese target entity.

Tax disadvantages:

Historical tax risks will be inherited by the buyer under a share deal

A share deal might trigger income tax implications for the seller.

B. Asset deal

Tax advantages:

Historical tax risks are not inherited by the buyer under an asset deal.

Tax disadvantages:

The seller to the transaction would be the Chinese target entity.

Various turnover taxes and the enterprise income tax would be potentially triggered in an asset deal, as it is treated as the sale of assets of the Chinese target entity.

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 a share deal the fair value of the net assets of the target entity shall be adopted. Expected that as the asset appreciation is recognised at the target entity level and reasonably allocated to each asset items, the step-up of the value of the tangible and intangible assets of the target cannot be achieved

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

China tax regulations do not allow goodwill to be depreciated.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Financial costs engaged during the usual course of business are deductible if they are not to be capitalised. Interest on loans granted to persons other than shareholders is deductible if:

- i) the borrowing and lending are genuine; and
- ii) the enterprise and individual have concluded a loan contract.

Interest deductibility is limited to the market rate on similar loans

Interest paid to a related company is deductible if the debt/equity ratios are observed:

- i) 5:1 for financial service enterprises; and
- ii) 2:1 for non-financial enterprises.



Those ratios do not apply if a company can prove that:

- the loan is at arm's length;
- or the effective tax rate of the borrowing enterprise is not higher than that of the lending enterprise within China.

Interest on the debts in excess of the ratios will be non-deductible.

Non-deductible interest (i) cannot be carried forward and (ii) will be re-characterised as dividends subject to corporate income tax

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

Due to the foreign exchange control and in accordance with relevant tax regulations, onshore and/or offshore related and 3rd party loans can be considered but with certain limitations, i.e., offshore loans would be subject to the foreign loan quota, while related party financing is subject to thin-capitalisation rules.

Other traditional debt push down techniques might also be considered, such as setting up a new China entity, funded with debt, to acquire the trade and assets of an existing China entity; acquiring another Chinese entity from the non-Chinese holding entity, or through transfer pricing arrangement, etc., while relevant tax costs under each scenarios shall be considered.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no such kind of tax incentives in China.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Yes, the losses remain valid at the target entity level after the share deal. The target's tax losses cannot be utilised by the holding entity.

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

Usually in a China tax due diligence, the indirect share transfer risk and management fee deductibility risk will be the key items to be assessed.

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

Yes, both parties to the agreement would be subject to the stamp duty at 0.05%.

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

Acquisition costs shall be capitalised and are thus not deductible until the investment is disposed. Costs and expenditures incurred associated with the transaction that do not qualify for capitalisation can be recognised in the respective tax period for the income tax purposes.

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

VAT would only be triggered in an asset deal as it is treated as a sale of assets to the buyer. If the buyer has obtained the general VAT taxpayer status, the VAT incurred on the purchase of assets and substantiated with a special VAT invoice can be credited against the output VAT incurred on taxable income of the buyer. The tax regulations also provide certain circumstances where the input VAT credit cannot be claim, which shall be assessed based on the asset list and prior to the transaction.

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

There is no specific tax concern for the buyer, while, from the legal side, certain formalities with the Chinese authorities are required before a Chinese legal entity is invested into overseas.

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

Tax neutrality will normally require a lock-up period for the investor's shareholding. The period could be 1 year or 3 years depending on different kind of restructuring case.

China in principle does not have a group tax reporting mechanism.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

In a share deal, no specific tax issues solely apply to real estate. However, if the tax authorities assess the share transfer to be solely for the purpose of transferring real properties, relevant land appreciation tax implications might be triggered.

In an asset deal, the transfer of real properties would be subject to land appreciation tax, business tax (which might be converted to the VAT shortly) and deed tax, as well as other collections associated with real estate transactions.

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

No such kind of policy exists in China.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains are taxed at 10% for non-residents, and 25% for residents. Some preferential treatments on exemption of capital gain tax are available in Circular 59:

Article 5: Where enterprise restructuring complies with the following conditions simultaneously, special tax process provisions shall apply:

- 1) It has reasonable commercial purpose, and reduction, exemption or delay in tax payment is not its primary purposes.
- 2) The proportion of acquired, merged or separated assets or equities conforms to that stipulated herein.
- 3) The original real operating activities of the restructured assets are not changed in the consecutive 12 months after the enterprise restructuring.
- 4) The equity payment amount involved in the transaction consideration of the restructuring conforms to the proportion stipulated herein.
- 5) The original major shareholders to whom the equities are paid in enterprise restructuring may not transfer its equities obtained in the consecutive 12 months after the restructuring.

Article 7: In the event that the enterprise engages in equity and asset acquisition transaction between, within and beyond the borders of China (including Hong Kong, Macau and Taiwan regions), a special tax process may not be



applied unless the following conditions are met, in addition to the conditions stipulated in Article 5 of Circular 59 hereof:

- 1) When a non-resident enterprise transfers resident enterprise equity in its possession to another non-resident enterprise with 100% of its direct holdings, no change in income withholding tax of the future transfer of such equity is caused thereby, and the transferring non-resident enterprise undertakes to the competent tax authority in writing that it will transfer equities it possesses of the transferred non-resident enterprise within 3 years (including 3 years);
- 2) A non-resident enterprise transfers to a resident enterprise with 100% of its direct holdings equities it possesses of another resident enterprise;
- 3) A resident enterprise invests in a non-resident enterprise with 100% of its direct holdings with the assets and equities in its possession; and
- 4) Other cases approved by the Ministry of Finance and the State Administration of Taxation.

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

Before 2007, there was some preferential treatment on the reinvestment of the dividends. However, no current effective tax policy is to date available.

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

Business substance is not required to set up a holding structure. However, the business substance would be essential in the beneficial owner test in the application for tax treaty treatment.

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

The same tax deferral regime as listed in point No. 18.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

No such kind of policy exists in China.

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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 recognised several corporate reorganisations as tax neutral transactions. In particular, current tax rules recognise mergers, spin-offs and capital/in-kind contributions as tax neutral transactions. These new rules (introduced and developed since 2012) submit the tax neutral status to different requirements that must be accomplished with; among others, 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 DIRECTIVES?

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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A) Share deal

As a general rule the transfer of shares of Colombian companies generates Colombian source income for the seller. The capital gain generated in the transfer of shares is subject to capital gains tax in Colombia at a rate of 10%; provided, that the sold shares 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 in a 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed in 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 shares 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 shares 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 amortised 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 amortisation 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.

In addition 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 case of share deals.

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

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

Notwithstanding, there is a transitory regime for the outstanding balance of goodwill originated before the enactment of Law 1819 of 2016 that allows the amortisation for tax purposes of such balance in a period of five years as of year 2017.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

As a general rule, interests 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 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.

In addition it is important to note that Law 1607 of 2012 introduced a thin-capitalisation rule to the Colombian tax system. According to this rule interests generated by liabilities of which the total average amount during the year does not exceed the amount resulting from 3 times the net worth 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 the amount resulting from 4 times the net worth of the taxpayer on 31 December of the previous year.

The thin capitalisation 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 USUAL 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 Colombia 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 purposes of amortising debt but it may not be applicable in order to amortise goodwill derived from the purchase of shares (the amortisation 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 not incentives for equity financing under Colombian tax law.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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.

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 extent covered under these pre-deal processes. 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 derived from 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 set-forth by law 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.

As 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, it 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.

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

Foreign companies are allowed to freely acquire participation in Colombian companies. Foreign exchange regime must be observed (i.e., registration of the investment in Colombia before the Central Bank) in order for the repatriation of dividends for instance. Foreign head companies are subject to tax in Colombia only on their Colombian source income.

Dividends are considered Colombian source income. The parent foreign company will be subject to tax on dividends perceived 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 the 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 corresponds to profits not subject to tax at the corporate level (from 33% to 35%). These changes will apply to profits generated as of 2017.

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



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

Prior to 1 January 2013, all kinds of mergers and spin-offs were income tax, capital gain tax and value added tax free 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 already existing companies or are used for creation of new companies.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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

In accordance to 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 dispositions of DTTs in connection with the capital gains obtained in a sale of shares of companies whose main assets are real estate.

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. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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

Share deals

As a general rule the transfer of shares of Colombian companies generates Colombian source income. The capital gain generated in 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 increased up to 40% (year 2017), 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 in the Colombian stock exchange. This will not apply if the operation is subject to the transfer pricing rules.

On the other hand the profits obtained from the sale of shares listed in the Colombian stock exchange will neither be subject to income tax nor to capital gains tax, provided that the sale does 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 value of the shares is derived in more than 50% from real estate located in Colombia, directly or indirectly. 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 a 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 40% (FY2017) 37% (FY 2018) and 33% as of year 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 sales 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 sales 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.

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

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

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

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

Please also note that DTTs currently in force with Colombia requires 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 it is aimed at distributing such passive income to the Colombian tax resident.



21. 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 reorganisation (including the shareholders of the merged/spin-off entities) generate any sort of income or gain derived from such processes.

Per the Colombian tax code, merger 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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

In case of share-based payments, companies shall recognise the expense when it is accrued while employees shall recognise and 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 in a 15%, in the case of shares not listed in a stock exchange. If the shares are listed in 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 purposes of expense deductibility, companies must make the contributions to the Social Security and perform the withholding tax on labour payments.

On the other hand, in 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 recognised when the employee exercises the option.

The expense for the company shall correspond to the shares' equity value (book value) increased in a 15% in the case of shares not listed in the stock exchange. If the shares are listed in 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 recognise income in an amount equivalent to the price paid for the shares and the fair market value of the shares on the date in which the purchase option is exercised.

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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:

- ❖ A number of anti-avoidance provisions have been introduced which give the right to the Tax commissioner to refuse to accept tax free reorganisations if the Commissioner is not satisfied that there were real commercial or financial reasons for such reorganisation and if he can determine that the main purpose of the reorganisation is the reduction, avoidance or deferment of payment of taxes. In practice, the Commissioner can deny exemption from tax of any profits arising from a re-organisation, 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
- ❖ Cyprus law has been amended so that as of 1 January 2016 dividend income is no longer exempt from the taxation to the extent it is deductible in the jurisdiction of foreign paying company

In addition to the above it should also be noted that transfer pricing rules are expected to be introduced in Cyprus, which will have an impact on all transactions between related parties. It has been announced that transfer pricing rules in relation to back-to-back loan arrangements will be applicable as of 1 July 2017 onwards.

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 various BEPS actions and EU directives. Below we briefly summarise a number of such changes and expected changes.

- ❖ **Action Point 2:** Cyprus law has been amended so that as of 1 January 2016 dividend income is no longer exempt from the taxation to the extent it is deductible in the jurisdiction of foreign paying company.
- ❖ **Action Point 4:** This action is not expected to result in any changes in Cyprus since it will mostly be applied by countries which have a high income tax rate and as a result will want to limit the deduction from their taxable income.
- ❖ **Action Point 5:** Cyprus has amended its IP regime effective as from 1 July 2016. The new regime fully complies with the OECD guidelines, and provides for the maximum transitional period possible.
- ❖ **Action Point 6:** The Cyprus Minister of Finance announced in April 2017 that the signing of the Multilateral Instrument has been approved by the Council of Ministers, and the signing is schedule to take place in Paris on 7 June 2017. This will effectively mean that the double tax treaties that Cyprus has entered into with other countries which ratified the Multilateral Instrument will be considered as automatically including the Limitation of Benefit provisions.
- ❖ **Action Point 13:** On 1 November 2016 Cyprus signed the Multilateral Competent Authority Agreement ("MCAA") on the automatic exchange of country-by-country reports, with subsequent issuance of Decree on 30 December 2016. Additionally, the introduction of transfer pricing rules in Cyprus, including transfer pricing documentation, is inevitable. It has already been announced that as of 1 July 2017, any Cyprus companies with back-to-back loan arrangements will have to have transfer pricing studies in place in relation to these.



- ❖ **Action Point 15:** The Multilateral Instrument was agreed together with a large number of countries in November 2016, and the signature is expected to be carried out in June 2017.

In regards to the EU Directives, the Parent/Subsidiary directive was implemented during 2016, whilst the Anti-Tax Avoidance Directive is expected to come into force by 1 January 2019 (1 January 2020 for exit taxation).

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A) Share deal

In 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 effected as a result of company re-organisation.

The stamp duty varies from nil to 0.20% and is capped at EUR20,000.

B) Asset deal

In an 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 EUR 85,000 of the sale price or market value
- ❖ 5% on amounts between EUR 85,001 and EUR 170,000
- ❖ 8% on any amount exceeding EUR 170,000

In 2016 a 50% exemption on the above fees applicable to immovable property transfers taking place between 16 July 2015 and 31 December 2016, irrespective of the date of the signing of the relevant contract or its submission to the Land Registry or to contracts signed and submitted to the Land Registry between 2 December 2011 to 31 December 2016 irrespective of the transfer date.

During 2017 it has been announced that it is planned for this exemption to become a permanent exemption.

The law is applicable in the situations where VAT is not applicable. In these cases the bill provides that transfer duties shall be reduced by 50%, and in particular this applies in transactions where:

- ❖ transfer fees either apply or are due;
- ❖ and the transfer is in regard to land, buildings or interests in land or indivisible interests that are sold for the first time from the issue date of the building permit;
- ❖ and the contract is submitted for the first time to the local District Land Registry during the period of application of the law i.e. between 2 December 2011 to 31 December 2016.

On the other hand, for the period 2 December 2011 to 31 December 2016, there is a 100% exemption to the above transfer fees if the transfer relates to a transaction that is subject to VAT.

Immovable Property Tax is abolished as from 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 apply 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 things located or 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 would be tax neutral. Depending on the nature of the assets transfer fees may apply.

The purchase of 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 allowed in the case of a share deal, 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 effected 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 AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Goodwill is not subject to depreciation or amortisation. 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 for the production of 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.

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

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

Cypriot law has an absolute prohibition on financial assistance given by a company whether directly or indirectly, for the acquisition of its own shares. It also prohibits the shares of the holding company in the case of a subsidiary company. 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 for the future) is also possible, allowing allocation of obligations according to annual profits.

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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 - ie 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 BY FOREIGN COMPANIES?

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 will be introduced in relation to financing companies.



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 the industry sector involved and the investor's jurisdictional origin.

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

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.

It is important to note that 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 though, 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).

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 sales 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 from 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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. 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 centre; 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.

21. 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 because 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 paid on transfers of immovable property from one company to another, under an approved reorganisation scheme,
- ❖ Mortgage fees are not paid 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 to accept tax free reorganisations if the Commissioner is not satisfied that there were real commercial or financial reasons for such reorganisation and if he can determine 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, in granting the approval for the reorganisation, has also the right to impose conditions on the number of shares that can be issues 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Employees relocating to Cyprus have two tax incentives. Namely:

- ❖ 50% exemption of remuneration exceeding EUR 100.000 per annum 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.
- ❖ Exemption equal to the lower of (a) 20% of the remuneration from any office or employment exercised in Cyprus by an individual and (b) EUR8.550. 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 addition to the above incentives, there are also a number of types of income which are exempt from personal income tax. These include:



- ❖ Dividend income of individuals who are not Cyprus tax resident and not Cyprus domiciled,
- ❖ Interest income (except income arising from the ordinary business activities or closely related to the ordinary business, activities) of individuals who are not Cyprus tax resident and not Cyprus domiciled,
- ❖ Remuneration from salaried services rendered outside Cyprus for more than 90 days in a tax year to a non-Cyprus resident employer or to a foreign permanent establishment of a Cyprus resident employers,
- ❖ Lump sums received by way of retiring gratuity, commutation of pension or compensation for death and injuries,
- ❖ Stock options provided as a 'benefit in kind' are taxed as part of salaried income. However any profits from the sale of securities (including shares, bonds, debentures, founders' shares and other securities of companies or other legal persons, incorporated in Cyprus or abroad and options thereon) are exempt.

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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?

The latest relevant development on legislation relevant for M&A deals is the adoption in June 2016, by the Danish Parliament of a bill which reduces the Danish withholding tax rate applicable to non-Danish companies from 27% to 22%. The new bill brings the dividend withholding tax rate imposed on non-Danish companies subject to limited tax liability in line with the corporation tax rate applicable to Danish companies.

In July 2016, a bill reintroducing the rules governing employee share schemes entered into force. Companies are now able to grant their employees employee shares at no cost or at a favourable price without the employees being taxed at the time of grant/exercise. The taxation is instead postponed until the employee sells the shares, at which point any realised gains will be taxed at share income (maximum 42%) instead of ordinary salary income (maximum 56%). The company is at liberty to decide whether the shares should be granted to all of its employees or only to certain employees.

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 the directive anti-abuse provision and the tax treaty anti-abuse provision. 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 was not yet 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 as to the obtaining of tax directive or tax treaty benefits will be introduced with the entering into force of the proposed provisions. Uncertainty will at least exist pending specific administrative or court practice 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 as well implemented Action Point 13 of the BEPS Initiative (Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting). The OECD 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 BEPS Action Point 15 (Multilateral Instrument), Denmark has not taken a position on whether or not it is going to sign the Multilateral Instrument.

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

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 as main rule 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 of 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, however, 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.

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 of share transfers compared to 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. However, in a share deal, financial goodwill (the portion of the purchase price that cannot be allocated to the assets of the target) cannot be amortised.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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.
- 2)** A limitation based on the value of assets: Net financing expenses are limited to an amount corresponding to 3,2% of certain assets (the asset limitation). The rate of 3,2% is adjusted annually.
- 3)** A limitation based on annual profits: Net financing expenses may not exceed 80% of earnings before interest and tax (the EBIT limitation).

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

Given the Danish interest limitation rules, push-downs are something to avoid.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no incentives for using equity financing in Denmark.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 8,025,000 (approximately EUR 1,079,000). 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 8,025,000 for the group as a whole.

If the loss carried forward exceeds DKK 8,025,000, 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 as the 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 very specific items that must be included compared to a generic tax due diligence. 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.

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 the management.

Furthermore, it should be noted that the Danish Tax Authorities in the past years have been challenging the deductibility of internal labour cost accrued in connection with M&A activity carried out by a company. As a result the Danish High Court has in June 2016 decided that internal labour cost accrued in connection with M&A activity cannot be deducted. The court's judgment has been appealed to the Danish Supreme Court.

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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 as regards 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

As a general rule, the disposal of receivables will trigger Danish capital gains taxation. Taxable capital gains are taxed at the regular corporate income tax rate of 22% for 2017.

❖ Sale of shares – distribution of dividends

Shareholdings are divided into two groups depending on the ownership percentage.

Tax exemption is granted for dividends received by and 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 are obligated to exchange information with the Danish tax authorities according to a DTT or another relevant agreement.



By contrast, if the shareholding constitutes less than 10% of the share capital (portfolio investments) and the shares are “listed shares” (shares that are listed on the stock exchange or similarly regulated markets), dividends received by and capital gains realised on the transfer of shares are subject to tax at the ordinary corporate tax rate of 22% for 2017.

❖ 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.

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

Aside from certain rules that apply to investments in real estate, there are no fiscal advantages when reinvesting the proceeds from a sale.

20. 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 general anti-avoidance rules (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.

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

Denmark has fully implemented the merger directive.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 The Law of Assessment 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 relevant recent developments in Finland relate closely to the BEPS project and case law giving insight on the application of the general anti-avoidance rule. The Finnish Tax Administration is aggressive in challenging existing structures and arrangements, which places taxpayers in position to evaluate and document their actions prudently.

In 2016 the Finnish Supreme Administrative Court issued two precedents (KHO 2016:71 and KHO 2016:72) on debt push down having importance for the deductibility of interest expenses in taxation, allocation of income and assets to permanent establishments and for application of the general anti-avoidance rule. Both cases concerned a situation where a foreign group company had a branch in Finland to which another group company's shares were sold and the sale was financed with an intra-group loan. The deductibility of interest expense resulting from an intra-group sale of shares was denied from a Finnish branch in both cases. In the former case, denial based on the interpretation of the income tax treaty whereby the shares acquired by the branch were not treated as assets belonging to the branch and therefore related acquisition debt interest was deemed non-deductible. In the latter case, the Court applied the general anti-avoidance rule and it held that the structure was missing sufficient commercial justification.

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 recently, the Supreme Administrative Court held in force an Administrative Court ruling in favor of taxpayers stating that carried interest was treated as capital income instead of earned income. Moreover, recent case law has reduced the attractiveness of PIK loans provided by private individuals. In private equity deals, partnership loans have been replaced by preference shares. Additionally, interest deduction limitations that entered into force in 2014 have impacted structuring of the deals.

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. Finland has already enacted restrictions on deductibility of interest and has CFC legislation in place. Additionally, Finland has implemented country-by-country reporting rules that apply to accounting periods ending in year 2017 or later.

The Finnish Ministry of Finance has released its proposal relating to Finland's approach with respect to the multilateral instrument. According to the proposal, Finland would implement only the minimum standards meaning that it would make reservations to other articles. Therefore, among other things, the existing provisions concerning permanent establishments in Finland's current tax treaties remain unchanged.

With respect to BEPS action 6, the Finnish Ministry of Finance has not expressed intention to take other actions than to implement related minimum standards in the multilateral instrument. According to the proposal, Finland would fulfil the minimum standard of Article 7 of the multilateral instrument by adopting the Principal Purpose Test. Finland would not adopt the additional provision that gives the competent authority the right to grant the treaty benefits even though the Principal Purpose Test provision applies.



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

- ❖ **Article 6 - Purpose of a Covered Tax Agreement:** Finland would amend the introductory paragraph 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 include the preamble text, which indicate 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. Admittance to the arbitration process would be limited to cases concerning transfer pricing or permanent establishments and to tax periods subsequent to the entry into force of the multilateral instrument.

New provisions of the Parent-Subsidiary Directive have been implemented in Finnish tax law with the effect from the beginning of 2016. The amendments included a Limitation-On-Benefits (LOB) rule and a General Anti-Abuse Rule (GAAR).

The LOB rule tackles the use of hybrid instruments in tax planning i.e. situations in which payments are treated as deductible expenses in the source Member State and as a tax exempt dividend in the recipient Member State. As an exception to the general rule of tax exemption of dividends provided by the Parent Subsidiary Directive, the dividend is taxable if either one of the following two conditions are met:

- ❖ The payment is deductible for the distributing company; or
- ❖ The arrangement in question has as a main purpose or as one of the main purposes to obtain tax benefits and the arrangement is not genuine having regard to all relevant facts and circumstances.

The general anti-abuse rule introduces a principal purpose test, providing that the arrangement is considered not to be genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

The Ministry of Finance is currently surveying the economic side of the implementation of the Anti-avoidance directive (ATAD). The report on the economic side of the ATAD implementation is estimated to be released in spring 2017. The legislative work relating to the implementation of the ATAD will start after the report has been released.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax disadvantages:

A share deal may be less preferable from the buyer's perspective for two reasons. Firstly, the transfer tax of either 1.6% or 2.0% of the acquisition price is levied on the transfer of other than publicly traded shares in Finnish companies. If the value of the company is mainly based on other aspects than the securities or real estate it owns, then the basis for transfer taxation can be significantly higher in comparison to an asset deal.

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.

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 fulfills 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. 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 provisions in the Finnish tax law provide for a step-up in the value of the target's underlying assets upon the acquisition of its shares. The acquisition cost of the shares is deductible from sales proceeds if the shares are later sold by the purchaser unless a participation exemption applies.

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

For tax purposes, 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 an intangible asset that cannot be separately disposed of or sold. In an asset deal the possible purchase price paid for goodwill is depreciable during the probable economic impact period of goodwill (maximum ten tax years). The value of the goodwill is allocated to the number of years and the depreciated amount remains the same each year.

In a share deal the goodwill cannot be amortised or depreciated for tax purposes. The entire acquisition cost of shares usually becomes deductible only in a subsequent transfer unless the participation exemption applies.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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. Limitations concerning the tax deductibility of interest payments have been applicable to corporations, partnerships, corresponding foreign entities and their permanent establishments as of the fiscal year 2014. The limitations are applied only if the interest expenses exceed the interest income received by the company. A general safe haven of EUR 500,000 is applied; if net interest expenses (including third party and related party interests) exceed EUR 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 EBITDA (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. Further, 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.

The regulation allows an indefinite carryforward of interest expenses that cannot be deducted based on the above-mentioned restrictions.



In addition, transfer pricing provisions, general anti-avoidance provision and the provision on hidden profit distributions in Finnish domestic law may be applied to deny tax deductibility of interest expenses.

The limitation rules may change as a result of the EU anti-avoidance directive and may thereafter apply also third party interest expenses and real estate companies and other non-business entities that are not currently covered.

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

The use of a Finnish Special Purpose Vehicle (SPV) by a foreign buyer to acquire a Finnish target is the preferred strategy to push down debt for most acquisitions. The SPV is financed by loans from third parties or foreign group companies, which are often located in a jurisdiction with a low corporate income tax rate. As the deductibility of related party interest expenses has been restricted, 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. Alternatively the target may be merged with the SPV or liquidated 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 if it is tax resident in an EU Member State or in a country with which Finland has concluded a tax treaty and the treaty contains a non-discrimination article.

All these strategies have to be carefully analysed to avoid the application of anti-abuse provisions in Finland, as well as to comply with transfer pricing rules. The recent case law denying deductibility of interest expenses arisen 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?

Finland has no special provision that would give tax incentives for equity funding.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

As a main rule, tax losses incurred may be carried forward for the subsequent 10 tax years. However, if more than 50% of the shares in a company has changed hands during the loss year or thereafter, the right to carry forward losses is forfeited. 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 by the taxpayer and under certain conditions grant a special permission to utilise losses despite of the change in the ownership.

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.

Transfer of losses in a merger or a demerger is subject to conditions fulfillment of 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 was reduced from five years to three years starting from 2017 meaning that financial years ending in 2017 are subject to new limitations. Financial years ended in 2016 and earlier are still covered by five years' 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 five 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.

Recently, Finnish tax authorities have scrutinised in transfer pricing audits especially intra-group financing transactions, transfers of valuable intangibles between group entities and business reorganisations. If such arrangements are in place in the target company, they 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's (by the buyer).


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

The costs accruing directly from facilitating the acquisition, such as fees from legal and other professional services and transfer tax are included in acquisition costs of shares. The buyer cannot deduct or depreciate the acquisition cost of the shares in taxation but when determining taxable capital gain in potential future share sales the acquisition costs are deducted from the sale price (if participation exemption is not applicable).

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 cost of the acquired shares are not subject to depreciations. Due to this divergent treatment, drawing the line between the financing costs and other cost relating to the acquisition 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 BY FOREIGN COMPANIES?

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 source 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 partnerships, 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 fulfillment of certain conditions, for example in mergers, divisions and exchanges of shares, there are restrictions on the amount of cash contributions.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 real



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.

Residential housing companies, MRECs, RECs and other real estate companies are taxed under the Income Tax Act as they are not considered to have business operations. Due to this, real estate companies are not currently subject to interest deduction limitations.

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 due to the fact that 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?

In the Finnish tax system, corporations are taxed separately and there is not any tax grouping regime. However, Finnish group companies and Finnish permanent establishments can under certain conditions balance their profits and losses with group contributions. 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.

The applicability requires among other things that both the contributor and the receiver of a group contribution are resident in Finland and that they carry on business operations. Additionally, between the contributor and the receiver has to be a 90 % direct or indirect ownership relationship. The qualification requires also that the ownership relationship between the contributor and the receiver must have continued for the whole fiscal year and that the financial year of the contributor and the receiver ends at the same time.

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Under the participation exemption regime, capital gains derived by companies from the transfer of shares are not considered 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.

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

There is no specific tax advantage provided for reinvesting the sale proceeds.

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

There are no substance requirements for holding/finance companies tax resident in Finland. A company is Finnish resident on the basis of being established in Finland.

21. 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 dissolved company are transferred to another Finnish corporate entity or partnership. Shareholders of the merging company must receive the surviving company's shares in proportion to their shareholding and cash consideration may not exceed 10 per cent of the share capital. The merger provisions apply to EU/EEA companies covered by the merger directive and under Finnish case law in some cases also 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 exempted 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

In Finland, incentives related to employment are treated as earned income. Incentives for managing directors and members of the board are considered as earned income even though they are not in an employment relationship with the company and this cannot be avoided by providing the respective 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. The applicability of employee's or employer's contributions' depends on the nature of the instruments. For example qualifying synthetic options are not subject to social insurance contributions. The exercise of the options realises 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

For FYs ending after 30 December 2016, the exceptional contribution on CIT of 10,7% no longer applies, bringing the maximum effective CIT rate to 34.43% (standard CIT rate of 33.33% + 3.3% of Social security surtax over EUR 763.000).

Please also note that French CIT rate should decrease progressively from 33,33% to 28% for all entities by the end of year 2020 (Finance Law for 2017, article 11). This measure should apply in priority to small and medium sized companies, and to larger companies within a 4-year period.

❖ Extension of the 3% Contribution on dividend distributions exemption

Under the French Tax Code (FTC), a 3% contribution generally applies on the amount of dividends distributed by companies subject to corporate income tax in France (article 235 ter ZCA).

An exemption was however provided for distributions made between companies belonging to the same French tax consolidated group.

According to the decision issued by the French Constitutional Court on 30 September 2016, this limited scope of exemption entailed a discrimination and a breach of constitutional principles.

Following this decision, the Legislator decided to extend the exemption of the 3% Contribution on dividend distributions:

- Made to French consolidated companies and to EU-Companies subject to a corporate tax equivalent to the French CIT in the EU or in another State having concluded with France a tax treaty with an administrative assistance clause fulfilling the criteria for tax consolidation (i.e. holding at least 95% of the share capital of the French distributing entity).
- Made between French resident entities qualifying for the tax consolidation regime, but which have not elected for it.

This new regime applies as from 1 January 2017 (Finance Law for 2017, article 12).

On 29 March 2017, the Administrative Supreme Court extended the reasoning of the French Constitutional Court to distributions made before 1 January 2017 on the basis of the European Convention on Human Rights (decision No. 399506, Layher).

Refund claims relating to such distributions may therefore be based on this decision.

❖ Amendment of the parent-subsidiary regime and participation exemption regime

The French Constitutional Court (QPC n°2016-553, July 8, 2016) ruled that French provisions excluding the application of the parent-subsidiary regime to dividends received by parent companies unless they hold at least 5% of the capital and voting rights of the distributing company are unconstitutional.

Based on the EU-Directive, it is thus only required that the qualifying parent company holds at least 5% of the share capital of the distributing company.

The relevant regime was abrogated by Finance Law for 2016 (Law 2015-1918, December 29, 2016, article 91) although the French tax authorities had already taken into consideration the above-mentioned decision of the French constitutional court, specifying in its doctrine that the new regime applied as from February 3, 2016.

However, it shall be underlined that the minimal 5% voting rights holding requirements is maintained for the capital gain participation exemption regime (we refer to question 18).



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.

To date, there have not been further major modification applied to French legislation as regards BEPS actions and the Parents-subsidiary regime since French legislation already complies with BEPS and parent-subsidiary regime requirements.

French legislation shall however be harmonized by the end of 2018 in order to comply with ATAD (Anti-tax avoidance Directive) requirements although there should not be major changes brought to French legislation in this respect since French legislation already provides for exit tax, CFC rule, or hybrid mismatches rules in compliance with ATAD.

Some adjustments might nevertheless be necessary, e.g., as regards interest deduction limitation rules, although the question remains whether ATAD provisions shall substitute or be added to the former French applicable regime in this purpose.

The same interrogation could be raised as regards the general anti avoidance rule provided for by ATAD which could either replace or be added to the former French general anti-abuse provisions.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 Simplifiées (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 EUR 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 EUR 23,000;
- ❖ 3% from EUR 23,000 to EUR 200,000;
- ❖ 5% of the sale price exceeding EUR 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. However, 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).



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. However, 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 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.

From a tax perspective, the depreciation of a business asset is not allowed. Therefore, extra-accounting adjustments will be necessary.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are several rules that relate to the deductibility of interest on borrowings.

❖ 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. 2.03% for the full year closed on 31 December 2016). 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 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 EUR 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 France (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 in France 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 EUR 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.

❖ Proportional interest deduction restriction “French robot”

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 EUR 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 USUAL STRATEGIES TO PUSH-DOWN THE 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).

As a consequence, 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 companies 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 is no specific tax incentives for equity financing.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

❖ 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 characterize 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 offsetable 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 déficits 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 January 1st, 2004, losses may be carried forward indefinitely. However, it shall be specified the offsetable amount of losses carried forward is limited, i.e., losses carried-forward shall only be fully offsetable



against the following year taxable income up to EUR 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 EUR 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.

❖ **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”).

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 EUR 23,000.

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, Beteiligungsgesellschaft Larentia + Minerva mbH & Co KG, C-108/14 & C-109/14, July 16, 2015) and the French Supreme Court (in CE 20 mai 2016 n° 371940, 8e et 3e ch réunies., min. c/ SA Groupe Ingénierie 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 2015 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 BY FOREIGN COMPANIES?

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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 company and acquiring company 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: $\text{Financial expenses} \times [(\text{acquisition price} - \text{amount of contribution in cash}) / \text{average group debt}]$.

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 company subject to corporate income tax are taxed at the normal corporate income tax rate.

The acquisition of 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 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).
- ❖ The 3% Contribution on dividend distributions is not applicable to dividends distributions made within members of the tax group. Please note that dividends distributions made to tax consolidation regime qualifying companies established in the EU are also exempt from the 3% Contribution on dividend distributions (we refer to question 1).
- ❖ As regards intra-group dividend distributions within a tax-consolidated group, further to Steria case law (ECJ Steria, Sept. 2, 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.



- ❖ As regards 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%.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 a rate of 45% 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 formal claim, 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%).

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. 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 purpose is only management of its shareholding. Consequently, the substance level requirements for non-operating holdings are necessarily limited.

21. 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 EUR 500 (EUR 375 for companies whose share capital is less than EUR 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 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.

- 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

❖ Taxation of capital gains versus salary

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.

Salaries are taxed at the maximum tax rate of circa 45% plus social security contributions (between circa 18% to 24% - a case by case analysis must be performed to determine the level of taxation), whereas capital gains may benefit from the application of allowances:

- Shares held for less than two years are subject to the effective tax rate of 62% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%);
- Shares held for more than 2 years are subject to the effective tax rate of 39.5% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%);
- Shares held for more than 8 years are subject to the effective tax rate of 32.75% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%).

Higher allowances may apply under certain circumstances (e.g., for small and medium sized companies).

❖ Free shares plan

For free shares issued in relation with free share plans voted as from January 1, 2017, the following regime applies:

- The acquisition gain (the share value is fixed at the vesting date) is taxed as a capital gain up to EUR 300K (the allowance is computed from the vesting date to the date of the sale) and as a salary for the excess.

An employer contribution of 30% also applies at the date of the granting.

- Capital gains (difference between the selling price and the acquisition gain) are taxed as mentioned above, it being specified allowances are computed from the vesting date to the selling date.

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.

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.

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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. The tax legislation amended the Reorganisation Tax Act by tightening the conditions for the tax neutrality of hive-downs and share-for-share exchanges. Their tax neutrality in general requires that the transferring person receives as consideration new shares in the receiving entity. Other considerations by the receiving entity in addition to new shares (e.g. cash, shareholder loans) are permitted. However, the legislation requires that the fair value of such other considerations must not amount to more than (a) 25% of the book value of the contributed business assets or (b) EUR 500k (the amount must not exceed the book value of the contributed assets).

Regarding the tax loss forfeiture rules, the tax legislation implemented another exception to relief for non-harmful transactions (see no. 9 below).

M&A deals could also be affected by possible amendments of the Real Estate Transfer Tax (RETT) Act. The tax legislation is considering lowering the harmful threshold of direct and indirect share transfers in real estate holding companies from 95% to 75% or even lower (including partial exceptions). However, the implementation is not expected before 2018. The legislature is also discussing a limitation rule for royalties in order to challenge royalty payments to countries with IP box regimes. The idea is to prevent the deductibility of royalties if the taxation of the profit in the receiving state is considered low. The new law would become effective as of 1 January 2018.

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, Germany implemented provisions reflecting BEPS Actions 5 and 13. With regard to Action 5, Germany introduced a limitation rule for royalties (see above). 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. Furthermore, 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.

With respect to the recently published OECD Multilateral Instrument (November 2016), Germany will sign the agreement at the signing ceremony planned in June 2017.

❖ Parent-Subsidiary Directive

The recent 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

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

In a share deal, no step-up of assets in the target company is possible for the buyer. Further, the buyer acquires all tax risks from prior years associated with the company's shares and therefore requests 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 above). There are various options 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.).

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. 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 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.

Debt push-down is not an issue as financing can be easily provided to the acquiring company. Deductibility of interest expense depends on the requirements of the interest barrier rule (see no. 6.). 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 case of VAT exempt turnover).

Please note that the acquisition of a partnership interest is treated like an asset deal for German tax purposes. Therefore there is a step-up of the value of the assets for the buyer when acquiring partnership interests. Depreciations of the stepped-up assets (shown in a supplementary balance sheet) are allocated directly to the acquiring partner.

For the seller, the asset deal is in principle a taxable event. 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 allow the deduction only of loss carry-forwards in a fiscal year in the amount of EUR 1 million plus 60% of the income exceeding EUR 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 does in principle 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, minimum taxation rules have to be considered in cases where the taxable profit from the contribution exceeds EUR 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 IN YOUR COUNTRY?

German tax law allows a straight-line depreciation of goodwill over 15 years. For German GAAP purposes, however, the depreciation period of goodwill is generally 5 years.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS

❖ 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 in writing and beforehand 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 (taxable 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 1 year can be used to achieve an interest deduction in future years) and interest carryforwards (non-deductible interest might be deductible in future years if there is sufficient EBITDA in such a year). Interest carryforwards are subject to the change-of-ownership rules (see no. 9); EBITDA carryforwards elapse after 5 years.

The interest barrier rules do not apply if 1 of the following conditions is met:

- The annual interest burden (interest expenses minus interest income) is less than EUR 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 tolerable 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 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 expenses have to be added back for trade tax purposes (unless an amount of EUR 100,000 is not exceeded).

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

Various options are available to achieve a debt-push down. One option 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 (amended in 2015)

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 1 January 2017. This rule allows for losses to be carried forward if the relevant company continued 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?

There is a number of specific items which should be considered in a tax due diligence in Germany. This includes for instance (i) the validity of tax groups 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). Further, it has to 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 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 provide for sufficient substance and activities. This substance has to be proven to the Federal Central Tax Office in order to receive either a refund for withholding tax (WHT) or an exemption certificate so that no WHT is due in future distributions.

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, Germany levies under certain requirements RETT on a specially assessed property value (see no. 16).

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. This is generally difficult to achieve. 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 BY FOREIGN COMPANIES?

A foreign (non-German) acquiring company is subject to limited tax liability in Germany if it generates income from German sources. German sources are for instance given 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, 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 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 the German 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).

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

There are various options to reorganise a group after the acquisition in a tax-neutral environment.

❖ Options for tax-neutral reorganization 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 only receives new shares in the receiving entity (or limited other considerations, 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 are also applicable in 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

Also tax groups 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The main issue to consider when acquiring companies whose main assets comprise 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 share deal regarding partnership interests, RETT is basically levied if at least 95% of the partnership interests are transferred within a period of 5 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 (RETT Act could change in future, 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 holds indirectly or directly at least 95% of the shares in the controlled company involved in the reorganisation within 5 years prior to the relevant transaction and for at least 5 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 tax-exempt at the level of the parent company whereas 5 % of a dividend distribution would be subject to income taxes. 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).

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 its financial year.
- The parent company and the subsidiary must enter into a profit and loss transfer agreement for at least 5 years. The agreement must be consistently executed throughout the term of the agreement.
- The parent company must be an entity having its place of management in Germany and its registered seat in an EU/EEA member state.
- 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 in 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 for VAT purposes; otherwise the VAT group is invalid.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

In principle, capital gains from the disposal of German assets (including partnership interest) are subject to German income taxation.

An important exemption is the capital gain deriving 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).

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

Under certain conditions, there are some tax advantages to reinvesting proceeds from an asset sale in cases where real estate or buildings are sold and new real estate and buildings 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 4 or 66 years (as the case may be). However, if no new acquisitions take place in the relevant period of time, the reserve has to be dissolved, leading to retroactive taxation. Individuals selling shares can benefit from rules similar to those described for real estate (applicable to capital gains of up to EUR 500,000). There is no tax advantage to reinvesting sale proceeds from a share deal made by corporations.

20. 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 no. 10 and 14).

Holding companies do not qualify as entrepreneurs for VAT purposes if they are mere finance 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.

21. 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Various management incentive schemes (e.g. stock or stock option plans, phantom stocks) are available in Germany. An often implemented structure provides for a specific investment vehicle for the managers in the legal form of a partnership (e.g. GmbH & Co. KG). No specific tax benefits exist for those schemes (e.g. no sweet equity; except for a minor tax exemption). Rather, German tax authorities often challenge the treatment of the income derived from those schemes as capital investments and qualify them as income from employment. The background is that income from capital investments is in principle taxed at a rate of approx. 25%, whereas income from employment is subject to an income tax rate of up to 47% (i.e. individual income tax rate of the employee). Therefore, it is vital that the scheme is structured in a way that the benefits can be qualified as income from capital investment.

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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?

Greece transposed in April 2016 into its domestic legislation Council Directives 2014/86/EU and 2015/121/EU which amended the provisions of the EU Parent-Subsidiary Directive (Council Directive 2011/96/EE). As a consequence, the Greek Income Tax Code introduced the special anti-avoidance provision as well as the anti-hybrid rule.

Furthermore, 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.

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 the 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 realised 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 performed 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.

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 AMORTISATION OF GOODWILL 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 amortisation but should be annually tested for impairment. In case the UEL cannot be reliably estimated, goodwill is amortised equally within ten years. Tax wise, goodwill is amortised at a 10% rate annually.

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 amortisation depending on its UEL. If the difference is negative, it constitutes a gain from bargain purchase and should be recorded as profit in the Income Statement of the respective consolidated accounts.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 EUR 3 million, 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 USUAL STRATEGIES TO PUSH-DOWN THE 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 the merger can be achieved only if the merger is carried out for valid commercial reasons. Therefore, it is questionable whether a merger to be implemented for the sole purpose of facilitating a debt push down could meet the business purpose test.

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 an AE is subject to a duty of 0.1% payable to the Greek Competition Committee.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 entity 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 absorbed 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 have taken place since 2006. Thus, it is still uncertain whether tax liabilities of the periods from 2000 to 2010 have been time barred or not. In this connection, relevant jurisprudence should also be closely followed, in view of several cases pending before the Administrative Supreme Court regarding compatibility of such extensions with the Greek Constitution.

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, share 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 BY FOREIGN COMPANIES?

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 are preferable from the foreign tax resident seller perspective.

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


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 to be opted for, 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 reorganisations 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 scrutinised reorganisations performed under the other applicable frameworks from an anti-abuse perspective.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 reorganise 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 provisions seem to apply only with respect to private individual sellers and not to companies. The relevant provision that entered into force on January 1st 2014 has been under suspension from January 1st 2015 and up until December 31, 2017 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.



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

No specific advantage exists if the transaction price of the sale of the shares is reinvested by the seller company.

20. 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.a. 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.

21. 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.

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 reorganisations performed under the new ITC, if the reorganisation 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 reorganisation.

Mergers and spin offs implemented under Law 1297, Law 2166 and the restructuring provisions of the new ITC with respect to qualifying reorganisations 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

No specific management incentives are available from a tax perspective in Greece other than the favorable tax treatment of certain fringe benefits that apply to all employees, e.g. provision of health insurance policy up to an amount of EUR 1.500 per employee; participation in collective pension plan providing favorable tax rates and deferral of taxation; lunch vouchers up to EUR 6 per day per employee.

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INDIA

INDIA

INTERNATIONAL DEVELOPMENTS

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

❖ Phasing out of exemptions and reduction in the headline corporate tax rate to 25 percent

The Finance Act 2016 provides the roadmap for phasing out of the current tax exemptions and incentives under the overall plan of the Government to bring down the effective tax rate for Indian corporates from the existing 30 percent to 25 percent while doing away with the exemptions and deductions.

Further, Finance Act 2016 provides a tax rate of 25 percent to Manufacturing companies which have been set up and registered on or after 1 March 2016 and are engaged solely in the business of manufacturing or production of article or things and not in any other business, along with certain other conditions.

❖ Clarifications on taxation of Foreign Portfolio Investor

The Revenue authorities have clarified the applicability of indirect transfer provisions in the context of Foreign Portfolio Investor (FPI). The clarifications suggest that the indirect transfer provisions will not apply to any asset or capital asset mentioned therein, being investment held by a non-resident, directly or indirectly, in a registered Foreign portfolio Investor.

❖ Limit on interest deduction / thin capitalisation norms;

In light of Base Erosion and Profit Sharing (BEPS) Action plan 4, Finance Act 2017 has introduced new provisions as an anti-abuse measure to limit the interest deductions on debt arrangements between an Indian company and a Non-resident associated enterprise to thirty percent of the Borrower Company's EBITDA. Earlier, the Indian tax laws countered this through its transfer pricing regulations, which restricted the interest claim based on determination of the 'arm's length rate of interest' on a debt instrument.

❖ Lower rate of withholding for rupee denominated bonds

In order to encourage debt financing, the Finance Act 2017 has granted the benefit of a lower withholding tax rate of 5 percent in the case of Rupee Denominated Bonds (RDBs) with retrospective effect from 1 April 2016. Accordingly, any issuance of RDBs before July 1, 2020 would be eligible for the benefit of lower withholding of tax at the rate of 5 percent on the interest payout.

❖ Gift tax on receipt and deemed consideration on transfer of unquoted shares;

Finance Act 2017 has expanded the scope of the existing provisions that provided for taxation of the recipient of unquoted shares at lower than fair value (based on the differential between the fair value and actual consideration) to cover a larger set of instruments and circumstances. Also, a new provision has been introduced to subject the transferor of unquoted shares to tax on a minimum of the fair value of the unquoted shares. While the rules that applied to the earlier provisions provided for computation of fair value per share largely based on book value, a draft of the revised rules that has been released for public comments provides for computation of fair value based on book value of assets except for specified assets being jewelry, artistic work, shares, securities and immovable property.

However, it may be noted that at the time of publication of this guide, the final rules have not yet been passed by the Indian revenue authorities.

❖ Place of effective management guidelines

The place of effective management has been defined to mean a place where the key management and commercial decisions that are necessary for the conduct of business of an entity as a whole, are in substance made. This amendment is therefore expected to widen the scope for companies to be considered an Indian



tax resident. The amendment is intended to align the provisions of the Indian Income Tax Act with the Double Taxation Avoidance Agreements (DTAAs) entered into by India with other countries and is expected to be in line with international standards. While the Finance Act 2016 deferred the applicability of the place of effective management based residence test by one year, the Finance Act 2017 has confirmed its applicability from April 1, 2017, and accordingly applicable for Assessment Year 2017-18. The regulator has also issued the final guidelines that detail the manner of determination of place of effective management in various circumstances.

❖ **General Anti Avoidance Rules (GAAR) applicable from 1 April 2017**

GAAR being an anti-tax avoidance regulation, consists of a set of broad rules which are based on general principles in order to check the potential avoidance of the tax in general. These provisions are applicable from 1 April 2017 onwards. GAAR empowers a tax officer to re-characterise a transaction or ignore its effect for tax purposes, if he believes the transaction has been entered into with the primary objective of obtaining tax benefits.

❖ **Amended Tax Treaty**

The protocol of the India -Mauritius tax treaty has been amended to incorporate a Limitation of Benefit (LoB) clause to restrict treaty shopping and disallowing treaty benefits aimed at avoiding Indian taxes. Specifically, the capital gains tax exemption in source country has been withdrawn, for investment which are acquired after 1 April 2017. Similar amendment has been introduced in the India-Singapore tax treaty and its existing LoB clause has been suitably amended.

Also, the notification by Indian revenue authorities to consider Cyprus as a notified jurisdiction has been rescinded with effect from 1 November 2013.

The Finance Act 2017 has also provided that conversion of preference shares to equity is tax neutral. Earlier, such tax neutrality was expressly provided for convertible debt.

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?

India is not a member of OECD group but has always asserted on principles similar to BEPS in trying to protect its corporate tax base and has thus welcomed the recommendations made thereunder. The revenue authorities in India have been particularly aggressive in their tax policy and assessment approach whilst establishing presence of an Indian PE or making transfer-pricing adjustments on the basis of the perceived value creation.

Action plan 6 regarding preventing treaty abuse prescribes a LoB clause besides a Principal Purpose Test (PPT) clause, currently forming part of some Indian tax treaties. The Government has already introduced General Anti-Abuse Rules (GAAR) prospectively in its domestic tax law with effect from 1 April 2017, which addresses PPT to some extent by way of a treaty override in case of any “impermissible avoidance arrangement”. Emphasising the principle of substance over form, India also amended the residency requirements of companies as stated above, introducing the concept of place of effective management.

Taking this further, the protocol of the India -Mauritius tax treaty has been amended to incorporate a LoB clause to restrict treaty shopping and disallowing treaty benefits aimed at avoiding Indian taxes. Specifically, the capital gains tax exemption in source country has been withdrawn, for investment which are acquired after 1 April 2017. Similar amendment has been introduced in the India-Singapore tax treaty and its existing LoB clause has been suitably amended. Also, the notification by Indian revenue authorities to consider Cyprus as a notified jurisdiction has been rescinded with effect from 1 November 2013.

Furthermore, the Finance Act 2017 has introduced amendments to limit interest deduction (as mentioned in response to Query 1) in line with recommendations under BEPS Action plan 4.



Finance Act, 2016 introduced certain amendments in line with the recommendations under the BEPS Action Plan 1, Action Plan 5 and Action Plan 13 respectively to introduce an equalisation levy for specified services received by a resident, or a non-resident having a PE in India, from a non-resident (Action Plan 1), and also prescribed a reporting regime in respect of country by country reporting and a master file in line with the Action Plan 13.

Further, a patent box regime incentivising the companies by way of taxing the income derived from exploitation of patents in India at a concessional tax rate of 10 percent (Action plan 5). Under the OECD nexus approach, benefits are given subject to the extent of R&D activities that the taxpayer performs in the jurisdiction granting the preferential tax rules. The OECD nexus approach which uses the level of expenditure to determine the tax benefit granted, has been chosen as the preferred approach to decide the substantial activity requirement for IP regimes. As per the India tax law on preferential patent box regime, at least seventy-five per cent of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

In view of BEPS action plan 15, on 7 June 2017, the Government of India has signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting by India. The Indian government has also provided a provisional list of the Covered Tax Agreements and its reservations.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

In stock acquisitions, the transferee company acquires the shares of the transferor company from its existing shareholders for a consideration. The company's identity remains unchanged, and the company continues to be responsible for all of its liabilities existing before the transfer of shares. In a stock acquisition, the assets continue to be recorded at their book values, as they appeared prior to the transfer of shares. Further, the tax incentives and benefits available to the company prior to the transfer of shares generally continue to be available even after the transfer of shares, although the nature of each particular incentive or benefit would need to be analysed to determine its continuity. In certain cases, the brought forward business losses of the target company will not be allowed to be carried forward. (See "available losses after an acquisition" below.)

Further, a new provision has been introduced to subject the transferor of unquoted shares to tax at a minimum of the fair value of the unquoted shares. While the rules that applied to the earlier provisions provided for computation of fair value per share largely based on book value, a draft of the revised rules that has been released for public comments provides for computation of the fair value based on book value of assets except for specified assets being jewelry, artistic work, shares, securities and immovable property.

Gains arising on the sale of shares of an Indian company are normally liable to tax in India as either short term or long term capital assets (if held for more than 24 months, except in case of shares in a listed company, if held for more than 12 months shall be considered as a long term asset), unless specifically exempt or sheltered under a tax treaty. Stock acquisitions could also result in withholding tax obligations for the buyer. Indirect stock acquisitions are also liable to tax in India unless specifically exempt.

Share transfers are also subject to stamp duty. It is possible, however, to reduce such costs by dematerialising the shares of the target company, prior to the transfer of shares.

- Other considerations

Foreign Investments in India are regulated by the provisions of the Foreign Exchange Management Act, 2000, and the related regulations and press notes issued by the Indian government. The regulations prescribe the



upper limit for equity interest held by a foreign company in an Indian entity, depending on the industry in which the Indian entity operates. At the time of making the Investments in India, the Foreign Company must adhere to the applicable limits. Further, Investment in certain selected industries require the prior approval of the Foreign Investment Promotion Board (FIPB). With effect from 5 June 2017, the government has dissolved the FIPB. Approval for foreign investments would be now handled by the identified ministries based on the sector in which the foreign investment is proposed and in certain circumstances by the Department of Industrial Policy & Promotion (“DIPP”).

Further, when the seller or buyer is an Indian resident and the counter party is a non-resident, the sale or acquisition of shares could also be subject to certain pricing guidelines and filing requirements.

B. Asset deal

In asset acquisitions, a company’s assets and liabilities are transferred for a consideration specified separately for each asset or set of assets, typically in the form of cash or shares. Under the said mode of acquisition, the target company’s historical business liabilities are not carried over to the buyer, and the tax exemptions and incentives available to the seller are normally not available to the buyer after the asset acquisition. The assets acquired are recorded in the books of account at the amount actually paid for the particular asset.

An asset acquisition may also be subject to value added tax (VAT). VAT is levied on the transfer of movable or intangible assets. In India, VAT rates typically range from 5 percent to 15.5 percent, depending on the classification of the asset or goods. However subject to conditions, the VAT paid by the buyer may be offset against the buyer’s future output VAT liability. Given the imminent introduction of Goods and Service Tax (GST), VAT would be replaced by GST ranging between 5 percent to 28 percent.

A transfer of movable and immovable assets is also subject to stamp duty. Stamp duty is a state levy and is imposed in the state where the assets being transferred are located. Transactions may be structured so as to minimise stamp duty, particularly in certain cases involving the transfer of movable assets. It is important to assure that the entire transaction is carefully documented to support the valid legality of the transfer and the protection of the rights of the buyer and the seller. The transaction must also meet the requirements supporting the contention of a lower or nil stamp duty liability on the transfer.

Stamp duty may also be levied in the state where the agreement to sell is executed between the parties, in addition to the state in which the assets are located.

C. Other Modes of transferring assets

A transfer of assets from one entity to another may be structured using other mechanisms in a more tax-efficient manner, such as a slump sale or a demerger.

- Slump sale

In India, a “slump” sale is a sale of a business undertaking as a going concern involving the transfer of the identified business by the seller to the buyer for a lump sum consideration. The transfer of a business by way of a slump sale is generally perfected with the execution of a business transfer agreement, which regulates the transfer of business itself, including its various components, such as the assets, liabilities, employees, licenses and existing contacts.

The consideration for the transfer may be discharged by way of a payment in cash or shares. As it involves a transfer of the business as a whole without allocating value to the individual assets, the lump sum consideration would need to be split by the buyer among the various assets acquired for which a valuation of such assets would need to be undertaken.

This opens up some planning opportunities for the buyer in terms of ensuring that the depreciable base is of the asset is recorded in a tax-efficient manner.



Further, in a slump sale, the tax benefits and incentives available to the business undertaking may be transferred to the buyer, subject to the satisfaction of certain conditions.

Additionally, transfer taxes are lower than in an asset acquisition. Since the entire undertaking is transferred as a whole in exchange for a lump sum consideration, the transaction may be held to be a “sale of business” and the same is not akin to “sale of goods”. Only some of the States’ VAT legislations provide for specific deduction on such slump sale and other States’ provisions are silent on this aspect. However, several judicial precedents uphold the proposition that sale of business is not akin to sale of goods and accordingly, not subject to VAT. Under the proposed GST regime as well, the Government seeks to keep sale of going concern outside the ambit of GST.

Stamp duty implications are largely similar to those for asset acquisitions. In a slump sale, structuring options may be adopted to lower the impact of stamp duty to bring in efficiency for the stamp duty on movable assets.

Demerger

A demerger means the transfer of an identified business division from one company to another on a going concern basis through a court approved process. In a demerger, the consideration for the transfer of business is discharged by issuing “shares” to the shareholders of the seller entity in order for the transaction to be tax neutral.

In India, a demerger process requires approval by the National Company Law Tribunal (“Tribunal”) of the state in which the registered office of the company (ies) is located. The entire process can take between six and eight months, depending on the number of states involved and status of the company, i.e. whether the company is a listed or a closely held company.

In a demerger, the buyer has a compulsory obligation to record assets at their book value as appearing in the books of the seller at the time of the demerger. Further, the tax benefits and incentives available to the business division may be transferred to the buyer, subject to satisfaction of certain conditions.

Since the transfer of business takes place through sale of such a business as a going concern, there should persist no levy of VAT on such sale of business as a going concern. Where the state law has a specific provision on the levy of stamp duty in the approved scheme of arrangement (as approved by the jurisdictional tribunal), the stamp duty will be levied using the mechanism provided in the law. Typically, stamp duty is levied as a percentage of market value of the shares issued under the scheme of arrangement or as a percentage of the market value of immovable property, whichever is higher. In some states, the possibility of a no stamp duty position may be explored. An amendment to Indian stamp duty laws to levy stamp duty on mergers and demergers had been proposed but has not yet been passed by parliament at the time of publication of this guide.

Where the demerger involves two states (i.e., the assets of the business division are located in two states) and the stamp duty is levied under the stamp duty law of both states, a credit for the stamp duty paid in one state may be claimed in the other state, by carrying out the process prescribed under the state stamp duty law.

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 Indian tax law, in share acquisitions, the value of tangible and intangible assets continues to be recorded at the same values as prior to the transfer of shares. The value of tangible and intangible assets may be stepped up in asset acquisitions (either by way of an itemised sale or a slump sale), as discussed above.

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

Under Indian tax law depreciation is allowed on intangible assets such as know-how, patents, copyrights, trademarks, licenses, franchisees or any other business or commercial rights of similar nature. Although goodwill



is an intangible asset, it is not specifically included in the list provided under the Indian tax law.

While recent rulings have supported claiming of the amortisation of goodwill arising in certain situations, revenue authorities at the lower level could still litigate the same basis facts of the specific case. Through appropriate purchase price allocation exercises, the goodwill can also be split among the several business or commercial rights comprised. Subject to facts, depreciation can be claimed on some of these rights.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Under Indian tax laws, there are no direct thin capitalisation rules, however, in line with BEPS action plan 4, as mentioned earlier, a new provision has been enacted as an anti-abuse measure to limit deduction of “excess” interest payments to a non-resident Associated Enterprise (NR AE). “Excess interest” means the amount exceeding the lower of thirty percent of borrower company’s EBITDA and interest paid/payable to NR AE.

Further, deductions for interest on borrowings are allowed in the year in which the interest is paid or accrued. However, the interest paid or accrued on capital borrowed for the acquisition of an asset for the extension of existing business, in the period between the date on which the capital was borrowed and the date on which the asset was first put to use, is not allowed as a deduction and instead is considered as part of the cost of acquisition of the asset.

The Indian tax law also provides for disallowance of expenses incurred in relation to acquisition of shares/ investments which yield exempt income like dividend. Accordingly, interest expenses directly or indirectly related to such investments may also be disallowed.

❖ Tax withholding

Payments of interest are subject to withholding tax in India under the domestic law or the applicable tax treaty.

❖ Transfer pricing

An international transaction between two related enterprises must be transacted at an arm’s length price. Where the debt is taken by the Indian entity from a foreign related enterprise, the interest must be at an arm’s length price. If the Indian Revenue authorities are of the view that the interest is not at an arm’s length price, they may make an adjustment to the interest paid and reduce the deduction claimed.

❖ Regulatory provisions

In the case of foreign debt, the provisions related to external commercial borrowings are to be complied with. For further details, see the following section.

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

The strategies for a push-down of debt on acquisitions have to be analysed under two scenarios: foreign debt and local debt.

A. Foreign Debt

Foreign Debt raised by an Indian Company is governed by the External Commercial Borrowing (ECB) guidelines, which apply in the case of a push-down of the debt to the target company. Although foreign debt raised by an Indian company is subject to restrictions which do not typically enable a push-down of the debt to the Indian company, the position needs to be examined based on the facts of each case. Key conditions attached to the raising and utilisation of foreign debt include the following:

- ❖ Borrowers may raise foreign debt from internationally recognised sources such as international banks, international capital markets, multilateral financial institutions, export credit agencies, suppliers of equipment,



foreign collaborators, foreign equity-holders, etc. The ECB is classified into three broad categories (Track I, II and III). The foreign equity-holder must have a minimum equity interest of 25 percent in the Indian company to qualify as eligible lender. Further, in the case of foreign debt raised under automatic route in excess of USD 5 million from the foreign equity-holder, the ECB liability-to-equity ratio must not exceed 4:1.

- ❖ Borrowings from group companies (having the same parent as Indian company) and direct equity holders with more than 51 percent equity stake are also permitted, subject to certain monetary limits.

Foreign debt may be raised totaling up to USD 500 million (up to USD750 million for companies in infrastructure and manufacturing sectors) during a financial year, subject to prescribed restrictions.

Under the existing regulations, foreign debt is normally allowed for capital expenditure only and for making an investment outside India. Foreign debt can be used to meet working capital needs provided it is raised from the direct or indirect equity holder. However, it is specifically prohibited from being used for investment in the capital market or acquisition of a company (or part of a company) in India, for investment in real estate or for on-lending to other entities for any of the previous mentioned purposes.

The guidelines prescribe an all-in-cost ceiling on foreign debt sourced by an Indian entity. The all-in-cost ceiling includes interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees but will not include commitment fees, pre-payment fees / charges, withholding tax payable in Indian Rupees.

The current all-in-cost ceiling varies between 300 to 500 basis points over the six-month LIBOR, depending upon the tenure of the loan. These rates are different for each category of ECB and are regularly revised.

Further, foreign debt can be obtained in Indian Rupee using the following instruments:

- ❖ Rupee denominated ECB – It is essentially Track III ECB with a minimum maturity of 3/5 years and has specifications for lender/borrower and utilisations
- ❖ Unlisted NCDs (subject to FDI policy) by FPI's - FPIs are permitted to invest in unlisted corporate debt securities and securitised debt instruments
- ❖ Rupee denominated bonds – Any corporate or body corporate and Indian banks are eligible to issue Rupee denominated bonds overseas and can be subscribed / invested by an investor who is a resident of a country (subject to some conditions). The minimum maturity period for such bonds will be 3 years. These bonds can be used for a wide variety of activities other than specifically prohibited by FDI policy and certain other activities like purchase of Land, on lending etc.

B. Local debt

A loan taken by an Indian entity from local sources may be pushed down to the target company either by way of the merger of two companies (i.e. the company which has taken the loan and the target company) or by passing on the debt to the target company. For a merger of the two companies, approval must be obtained from the jurisdictional Tribunal by filing a scheme of arrangement. The entire merger process typically takes between six and eight months, depending on the states involved and the status of the company, i.e., whether the company is listed or a closely held company.

Alternatively, the company taking the debt may pass on the debt to the target company, subject to the satisfaction of conditions prescribed under corporate law.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

The key tax incentives expressly provided in the Indian tax laws are as follows:

- ❖ Exemption from long term capital gains tax on exit of listed equity shares (which has suffered STT)



- ❖ Period of holding for listed equity shares is 12 months as against 24 months, for the purpose of qualifying as “long term” capital asset
- ❖ Income from dividends is exempt in the hands of the equity shareholder [Exemption restricted to certain monetary limits for Individual and other specified shareholders].

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Indian tax law allows business losses to be carried forward and set off within the eight years immediately following the tax year for which the loss was first computed. There is no limitation on carry forward and setting off unabsorbed depreciation.

Certain restrictions have been imposed on carrying forward business losses where the target company is a closely held company. In such a case, the carry forward and set-off of business losses from earlier years are allowed only if the shares of the company carrying not less than 51 percent of the voting power are “beneficially held” by the same persons on the last day of the tax year in which the loss was incurred and on the last day of the tax year in which the loss should be set-off. The above rule does not apply, however, where the change in shareholder ownership of the Indian company, which is the subsidiary of a foreign company, is pursuant to a scheme of amalgamation or demerger of a foreign company and 51 percent of the shareholders of the foreign amalgamating or demerged company remain as the shareholders of the amalgamated or resulting 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?

- ❖ The Indian tax regulation permits the Revenue authorities to review the tax return/completed assessments of the assessee for a period of 8 years. Accordingly, all relevant documents are examined for a minimum of 8 years to confirm presence of any potential tax leakage.
- ❖ Tax residency documents to check validity of any benefits claimed under tax treaties
- ❖ Compliance with withholding tax obligations (as the same is heavily penalised including prosecution in case of non-compliance)
- ❖ Validity of any losses/ credits to be carried forward in case of a restructuring exercise carried out.

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

The transfer of shares attracts stamp duty at the prescribed rates. These costs may be reduced, however, by dematerialising the shares of the transferee company, prior to the transfer of the shares (the investor’s physical share certificates are converted to electronic format).

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

Indian tax law provides for deductibility of the acquisition costs at the time of subsequent sale of the said asset. However, where the asset acquired is used for the purpose of business or profession of the acquirer, the said acquisition cost would be deductible as depreciation over the life of the said asset.

Further, there is no specific provision for deduction of consultancy /advisory / legal fee paid for acquisitions. Any expenditure incurred wholly or exclusively for the purpose of the business or trade is allowed as a deduction under the Indian tax laws. Therefore, the tax deductibility of such expenditure depends on the facts and circumstances of the specific case. If the acquirer is able to establish business nexus then the acquisition costs could be claimed as deduction for tax purpose. The revenue authorities could however litigate the facts of the specific case.

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

VAT/CST is applicable on sale of goods. Typically, there should be no VAT/CST implications where the business is acquired as a whole, on a going concern basis with all assets and liabilities. However if the business is not acquired as a going concern, then the seller may charge applicable VAT on the assets transferred, input credit, subject to certain conditions and restrictions, should be available to the buyer.

Further no VAT is applicable to consultancy/advisory/legal fee paid for acquisitions. However such services would be subject to a service tax levy at the applicable taxes.

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

Regulatory considerations

Foreign investments in India are governed by the exchange control regulations, namely the Foreign Exchange Management Act, 1999 (FEMA). Acquisition of shares in an Indian target company should comply with the Foreign Direct Investment (“FDI”) policy. The FDI Policy in India today is fairly liberalised allowing investments into most sectors under the automatic route i.e. without Government approval. There are certain sectors where investments are permitted up to prescribed sectorial caps and few prohibited sectors such as agriculture, plantation, real estate trading etc. Further, till recently, any foreign investment into a holding company required an approval from the Foreign Investment Promotion Board (FIPB) [as mentioned earlier, this body is dissolved with effect from June 5, 2017]. Now foreign investment into holding companies is permitted without any approval for sectors under the automatic route. However, FIPB approval is required if such Indian target engages in any activity under the government route. Additionally, in case of listed target companies, Takeover Code regulations under the Indian securities law, namely Substantial Acquisition of Shares and Takeovers (SEBI) Regulations, 2011 will need to be complied.

Tax Considerations

Setting up an optimal structure for investments in India requires taking into account the relevant tax treaty network and provisions under the Indian domestic law. Planning an efficient holding structure assumes significance in view of the fact that India levies an effective dividend distribution tax of 20.35% on distribution of profits from an Indian company/target to the shareholder (foreign parent). Secondly, gains arising on the transfer of an Indian company shares by a foreign company held directly or indirectly i.e. qualifying under the indirect transfer rules, is subject to tax in India (except for listed company shares held for more than 12 months).

The place of effective management rules have been finalised. This amendment is therefore expected to widen the scope for companies to be considered an Indian tax resident. The amendment is intended to align the provisions of the Indian Income Tax Act with the DTAA's entered into by India with other countries and is expected to be in line with international standards.

India's network of tax treaties plays a crucial role in tax structuring of cross border investments into India. Even though most treaties follow source country taxation for interests, dividends and capital gains from alienation of shares, specific provisions in some tax treaties offer planning opportunities for structuring investments and acquisitions in India. Certain holding jurisdictions which have a favorable tax regime and beneficial tax treaty with India whereby India has foregone its taxing right on capital gains arising to a resident of these countries on alienation of shares, can help structure exits in a tax neutral way. However, the use of these favorable treaties to structure investments and divestments has been a matter of debate with tax authorities if the structure is not backed by commercial substance.

Most of India's new treaties or negotiated treaties include a LoB clause to prevent abuse of the capital gains benefit under the said treaty. With the recent developments relating to introduction of GAAR and increased scrutiny, selection of an appropriate tax structure is critical while planning acquisitions in India.



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

A group may reorganise in a tax neutral manner after an acquisition by way of (a) a merger of the group companies into a single company; (b) a demerger of non-core businesses of the group into a separate company to attain value for shareholders; (c) a capital reduction whereby a company can cancel its capital for consideration or against accumulated losses, or (d) a buy-back of shares whereby the group company may reduce its capital by buying its own capital from the shareholders and subsequently cancelling it, etc. However, to ensure tax-neutrality in the reorganisation, the conditions laid under Indian tax law must be satisfied.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

Under the provisions of Indian tax law, no specific regulations apply to the transfer of assets or shares of a company whose main assets are real estate. The transfer of real estate assets directly, however, is subject to capital gain tax computed in the manner specified in the Indian tax laws. Similarly, the transfer of real estate directly is subject to stamp duty at the rates prescribed under the state stamp duty laws or the Indian Stamp Act, where there is no state specific law.

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

No fiscal unity/ tax grouping permitted under Indian tax laws

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Under Indian tax law capital gains are computed by reference to the holding period for the capital assets by the transferee. There is no provision for participation exemption under Indian tax law.

To compute capital gains assets held for a period of 24 months or less are referred to as short-term capital assets. For shares of any listed security or equity oriented mutual fund unit or zero coupon bond, the period of 24 months is replaced by 12 months. Assets other than short-term capital assets are referred to as long-term capital assets. Gains arising from the transfer of short-term capital assets are known as short-term capital gains. Gains arising from the transfer of capital assets other than short-term capital assets are known as long-term capital gains.

Short-term capital gains are calculated as the sale consideration less the cost of acquisition, less the cost of improvement and expenses incurred at time of sale. Short-term capital gains are taxable at a rate of 30 percent (or 40 percent for non-residents), exclusive of the applicable surcharge and education cess. Short-term capital gains resulting from specified securities traded on a recognised stock exchange in India, and on which securities transaction tax is paid, are taxed at a fixed rate of 15 percent - exclusive of the surcharge and the education cess.

To calculate long-term capital gains, costs are adjusted for inflation based in indices issued by the Indian government. Long-term capital gains are calculated as the sale consideration less the indexed cost of improvement and expenses incurred at the time of the sale.

In case of non-residents, costs are adjusted for foreign currency fluctuation rather than inflation, while calculating long term capital gains. Long-term capital gains are taxable for non-residents at a fixed rate of 10 percent (exclusive of surcharge and the education cess) in the case of unlisted securities without indexation and foreign exchange fluctuation benefit and at a rate of 20 percent (exclusive of surcharge and the education cess) in other cases. Long-term capital gains resulting from the sale of specified securities traded on a recognised stock exchange in India (and on which securities transaction tax is paid) are exempt from tax.

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

Under Indian tax law exemption can be claimed for capital gains arising from transfer of long-term capital assets (including shares) if such gains are invested in a long-term specified asset (Bonds issued by National Highways Authority of India or Rural Electrification Corporation Limited or any other bond notified by the Central Government in this behalf) within a period of six months from the date of transfer. However investment in the specified securities may be made up to INR 5 million. Furthermore the investments need to be locked in for the prescribed period (typically three years) to claim the exemption. If the investments are transferred or otherwise converted into cash they are taxable in the year in which conversion takes place.

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

Till recently, any foreign investment into a holding company required an approval of FIPB. Under the extant exchange control regulations, foreign investment into holding companies is permitted without any approval for sectors under the automatic route. However, DIP approval is required if such Indian investee company engages in any activity under the Government Route. Foreign investment into finance companies is permitted up to applicable limits, subject to conditions including minimum capitalisation and prior approval of the FIPB in specified sectors.

Further, GAAR applicable from 1 April 2017 and the commercial rationale of holding companies would be subject to scrutiny by revenue authorities in light of the GAAR provisions. Where holding companies could be alleged to have been set-up for tax reasons, revenue authorities could, amongst various things, disregard the holding companies, re-characterise transactions/arrangements, deny treaty benefits etc. to bring them in line with the commercial substance.

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

As explained above, re-structuring by way of mergers or spin off have following implications on transfer:

- ❖ Amalgamation and demerger are specifically defined in the India tax laws and are tax neutral [where the stipulated conditions are met]
- ❖ Stamp duty is applicable on transfer and issue of shares and on transfer of immovable properties

Indirect Tax:

Any service provider or manufacturer who transfers his business resulting into change in ownership, shall be allowed to transfer the CENVAT credit lying unutilised in his account to the resultant entity.

The transfer of assets should be assigned a lump sum consideration. While individual value can be ascertained for each asset in order to arrive at the consideration, the business transfer agreement should clearly mention that sale is for a lump sum amount.

While some states clearly provide for exemption from VAT on “transfer of business as a going concern”, a strong case would have to be built in other states. Therefore, it might be prudent to file an intimation with the relevant tax authorities along with a copy of the business transfer agreement.

In a scenario where a lump sum consideration is not assigned, an itemised sale can be effected. However the same would be chargeable to VAT and input tax credit, subject to certain restrictions would be available to the buyer.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Key tax considerations on issue of employee stock options/ Sweat equity are as follows:

- ❖ The benefit arising on allotment of shares under an ESOP Scheme is taxable in the hands of the employee as perquisite on the difference between FMV and price at which the shares are issued to employees
- ❖ Company shall be required to withhold taxes on the value of such perquisite at the time of exercise/allotment of shares as perquisites under the head “Salary”.
- ❖ Employee stock option expenses debited in the profit and loss are deductible expenses, subject to litigation

The above implications only provide a high level overview and will change on case to case basis.

Separately, in case of business acquisitions, apart from the one time consideration, promoters may also be remunerated by way of a “Promote” or “earn outs” which are contingent payments to be received on the acquired business performing on the anticipated lines. While ordinarily, the “earn outs” would be subject to capital gains tax with the revenue alleging taxability in the year of transfer and the taxpayer contenting taxability in the year of receipt, alternative structuring options could be considered for such payments based on the facts and circumstances and commercial drivers.

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INDONESIA



INDONESIA

INTERNATIONAL DEVELOPMENTS

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

In 2008, the Minister of Finance issued Regulation No. 43/PMK.03/2008 regarding The Use of Book Value for Transfer of Assets in the Context of Mergers, Consolidations or Expansions, which enables companies to conduct a merger using book value (tax neutral merger).

The following conditions shall be applied to two or more companies that conduct a tax neutral merger:

- ❖ There is no capital gain incurred from 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 5% of the transaction price or Tax Object Sales Value (NJOP), whichever is higher.

Meanwhile, the surviving entity should pay 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 being deducted with Non-Taxable Value of Tax Object Acquisition/NPOPTKP (maximum of IDR 60 million). The surviving entity may request 50% reduction on this duty to the regional government. This reduction could 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 the surviving entities are registered as Taxable Entrepreneurs.

Under the regulation, the application to transfer assets at book value requires an approval from the Director General of Taxation (DGT). If the taxpayer does not obtain the approval from the DGT then the transfer of assets will be assessed at market 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?

Based on the prevailing Indonesian tax regulation (Director General of Taxes Regulation No. 25/PJ/2010), tax treaty abuse may occur in the following events:

- ❖ transaction without economic substance conducted using a structure/scheme in such a way with the sole intention to benefit from tax treaty;
- ❖ transaction with a structure/scheme in which the legal form is different from the economic substance in such a way with the sole purpose to benefit from tax treaty; or
- ❖ income recipient is not the actual beneficial owner.

Furthermore, a beneficial owner (either individual or entity) mentioned above shall be an income recipient who acts not as an agent, nominee, and conduit company.

In the event that a foreign taxpayer does not abuse the tax treaty, the foreign taxpayer shall be entitled to obtain benefits from the tax treaty.

Based on Director General of Taxes Regulation No. PER 24/PJ/2010, the criteria to apply for tax treaty benefits are:

- ❖ the income recipient is not an Indonesian tax resident;
- ❖ the administrative requirements to apply the tax treaty provisions have been fulfilled; and



- ❖ there is no tax treaty abuse done by the foreign tax resident as intended in the provisions on the prevention of tax treaty abuse.

The Foreign Taxpayer has to provide the Certificate of Domicile of Non-Resident 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 Indonesian Tax Office to confirm that the recipient is the Beneficial Owner and the transaction does not aim to exploit a tax treaty. Form-DGT 1 (page 1) is only valid for a period of one year since the date of issuance and must be renewed annually. The Certificate of Domicile must be submitted before the end of the submission of the Periodic Tax Return for the period when the withholding tax is payable.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

In Indonesia, the main differences among acquisitions made through a share deal versus an asset deal are as follows:

A. Share deal

- ❖ Capital gains received by an entity in a share deal are subject to corporate income tax of 25%, while capital gains received by an individual are subject to individual income tax in the range of 5% until 30%.
- ❖ Since shares are categorised as non-taxable goods, there is no VAT applicable in share deals.

B. Asset deal

Moveable Assets

- ❖ Capital gains received by an entity in an asset deal are subject to corporate income tax of 25%, while capital gains received by an individual are subject to individual income tax in the range of 5% until 30%.
- ❖ Generally, 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's business.

Immovable Assets (land and/or building)

- ❖ For the seller, the transfer of immovable assets is subject to final income tax of 5% of the 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 5% Duty on Acquisition of Land and Building Right (BPHTB) from the transaction price or Tax Object Sales Value (NJOP), whichever is higher after being deducted with the Non-Taxable Value of Tax Object Acquisition/NPOPTKP (maximum of IDR 60 million).
- ❖ Generally, 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 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 Indonesian income tax law to step up the value of the tangible and intangible assets in case of share deals.

In 2015, the Minister of Finance issued a regulation regarding tax incentive on fixed asset revaluation. The tax incentive reduces the previous final tax rate of 10% to a lower final tax rate. Below is the summary of the special tax rates applied to asset revaluation:

- ❖ 3% (three percent), for applications submitted starting from 20 October 2015 up to 31 December 2015;
- ❖ 4% (four percent), for applications submitted starting from 1 January 2016 up to 30 June 2016; and
- ❖ 6% (six percent), for applications submitted starting from 1 July 2016 up to 31 December 2016.

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.

Furthermore, the capitalisation of surplus of asset revaluation to paid-up capital is not subject to tax. However, this is in contrast to Indonesian Accounting Standard, which regulates that surplus of assets revaluation could not be capitalised at once.

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

Amortisation of goodwill which has useful life exceeding one year may be treated as expenses proportionally during 4 years, 8 years, 16 years, or 20 years using the straight line or double declining balance method.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are limitations to the deductibility of interest on borrowings. In 2015, the Minister of Finance issued regulation No. 169/PMK.010/2015 regarding thin capitalisation.

The debt-to-equity ratio should not exceed 4:1. The total balance of debts shall cover the balance of long-term debts and/or the balance of short-term debts, including the balance of trade payable which is charged with interest. Meanwhile, total balance of equity shall cover equity as intended in the applicable finance accounting standard and non-interest bearing loan of related parties.

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 amounting to interest expense in accordance with debt to equity ratio of 4:1.

Please note that in the event that a Taxpayer has zero balance of equity or less than zero, the related Taxpayer's entire interest expense cannot be deducted in calculating the taxable income.

Excluded from the provisions on the debt to equity ratio shall be bank, financing institution, insurance and reinsurance taxpayers, and taxpayers which carry on business in the mining and infrastructure fields.

Furthermore, interest on loans used for shares investment with ownership of no less than 25% could not be treated as deductible expenses since the dividend received by the investor is a non-taxable income.



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

There are no usual strategies to push-down the debt on acquisitions. However, there should be a consideration to complex tax issues such as transfer pricing, VAT, capital gains and interest deductibility prior to the implementation.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no tax incentives for equity financing applicable in Indonesia.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

The losses of the target company are available for 5-year carry-forward compensation. The tax authority might make an adjustment on the fiscal losses based on the tax audit process.

However, in the context of 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 value of up to IDR 250,000.00 (two hundred fifty thousand Rupiah) shall not be subject to Stamp Duty. If the value is above IDR 250,000.00 (two hundred fifty thousand Rupiah) and up to IDR 1,000,000.00 (one million Rupiah), the securities or documents shall be subject to Stamp Duty at the tariff of IDR 3,000.00 (three thousand Rupiah), while those having nominal value of more than IDR 1,000,000.00 (one million Rupiah) shall be subject to Stamp Duty at the tariff of IDR 6,000.00 (six thousand Rupiah).

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

Acquisition costs shall be the value of shares or asset and additional costs related to acquisition, such as advisory fees from the corporate finance advisor and/or legal fees.

The value of shares or asset shall be recorded as asset.

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 expenses in the year of shares acquisition (PSAK 22).

❖ Acquisition of Assets

The additional costs for asset acquisition which have useful life exceeding 1 year shall be capitalised and depreciated over the useful life (PSAK 16). The depreciation could be treated as expenses proportionally during 4 years, 8 years, 16 years, or 20 years using the straight line or double declining balance methods.

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

Generally, VAT input from assets acquisition could be compensated with VAT output in the following fiscal period or be claimed as tax refunds at the end of fiscal year. There is no VAT input for shares acquisition.

However, VAT input for assets categorised as non-capital goods acquired by a company that has not yet delivered taxable goods or services could not be compensated with VAT output in the following fiscal period or be claimed as tax refund at the end of the fiscal year.

The VAT input from the additional costs related to the shares or asset acquisition could be compensated with VAT output in the following fiscal period or be claimed as tax refund at the end of the fiscal year.

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

❖ Asset Deals

Foreign companies are not allowed to directly acquire land and/or buildings in Indonesia.

❖ Share Deals

Indonesian prevailing law (President Regulation No. 39 of 2014) regulates the percentage of foreign ownership limitation for different types of business in certain sectors.

In general, all types of business are open to foreign investment, except certain closed type of business and limitations of maximum ownership in several types of industries.

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

Yes, the group can reorganise after the acquisition in a tax neutral environment through mergers.

To apply for tax neutral merger, certain conditions must be satisfied. The conditions are the following:

- ❖ submitting an application using book values for merger to the Director General of Taxes, along with the argumentation and purpose of the merger,
- ❖ paying all tax payable from every related entity, and
- ❖ satisfying the requirements of business the purpose test.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

VAT input for a company that purchases real estate as its inventory could not be credited in case that the company has not yet sold or delivered the 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 the Indonesian tax law.



SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains must be combined with the company's revenue from its main business after being deducted with the deductible expenses. The net profit is subject to 25% corporate income tax. Further, for individuals, capital gains after being combined with their income shall be subject to individual income tax in the range of 5% until 30%.

There is no participation exemption regime available in Indonesia.

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

There is no fiscal advantage if the proceeds from the sale are reinvested.

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

Indonesian prevailing 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 types of industries of the operating companies under the holding company.

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

There are no special tax considerations regarding mergers/spin-offs. However, a registration to the Investment Coordinating Board in the framework of an Initial Public Offering has to become effective within 1 (one) year for the taxpayer who applies for spin-offs with the book value.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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”) of 20% (as opposed to the standard rate of 33%) has been introduced for entrepreneurs and the self-employed with effect from 1 January 2016. 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 15% of the shares in the company (or 15% of the shares in a holding company which holds 100% 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.

Certain anti-avoidance measures were introduced in Finance Act 2015. Of particular relevance to M&A deals is a provision to counteract schemes which are designed to avoid a CGT charge on the sale of Irish shares by non residents. Such schemes involved transferring cash to the company prior to the sale to ensure that the shares derived their value from cash rather than Irish land or buildings, and were therefore outside the scope of Irish CGT.

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, recently 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 was one of the countries which participated in the development of the Multilateral Instrument pursuant to Action 15. It has not yet been made public as to what reservations it will invoke. However it is expected that it will choose a Principle Purpose Test instead of a Limitation of Benefits clause to prevent treaty abuse.

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.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

Buyer's Perspective

Stamp duty

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.

For asset deals, the stamp duty rate is 2% 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”) accepts 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, 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 2 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 (eg 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 to.

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 10 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.

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 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 clawback provisions may apply if the asset is disposed of within 5 years of acquisition.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 75% of the interest accruing on or after 7 April 2009 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. However relief is not available to an individual in such circumstances.

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 USUAL STRATEGIES TO PUSH-DOWN THE 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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

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 14 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. The Irish tax legislation has not yet been updated to specifically allow domestic mergers to take place on a tax neutral basis and as such Revenue confirmations may be required in the event of a merger.

Subject to certain conditions it should be possible for a group to reorganise 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. Any such reliefs may be clawed back if the group relationship is broken within particular time limits.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

Withholding tax obligation

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 5 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.

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 EEA group (the CGT group does not extend to treaty countries beyond the EEA).

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 2 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.

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

Generally, there is no rollover relief available in Ireland.

20. 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.

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

As indicated above at section 15, the Irish tax legislation has not yet been updated to specifically allow domestic mergers to take place on a tax neutral basis and it is necessary to look at each situation on a case-by-case basis to determine the tax consequences. As such Revenue confirmations may be required in the event of a merger.

Stamp Duty

Cross border mergers effected under the EU Regulations should not be subject to stamp duty. Relief from stamp duty may be available on domestic mergers and spin-offs provided certain conditions are met. Revenue confirmation may be required in certain cases.



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 a 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. Revenue confirmation may be required in certain cases.

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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 in similar times 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 20% rather than the standard rate of 33%.

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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?

Italy's corporate income tax rate (IRES) is set at 24% starting from 1 January 2017 onwards (with a 3.5% surcharge for banks and financial institutions). Italy applies also a regional income tax (IRAP) on a taxable income specifically determined (the cost of labour is from 2015 fully deductible from such tax base) at a 3.9% rate, which is raised to 4.65% for banks and financial institutions and 5.9% for insurance companies (further limited surcharges may be applied by each region).


Recent tax law amendments regard, among others:

- ❖ a patent box regime in line with OECD approach;
- ❖ new types of rulings, including special rulings for companies with large investments to be realised in Italy (over 30 million euro) or about the existence of a permanent establishment in Italy;
- ❖ 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);
- ❖ a tax exemption regime for income deriving from long term (5 years) investments made by individuals in securities issued by Italian companies or EU/EEA entities with a permanent establishment in Italy (for yearly investment not exceeding EUR 30,000 and EUR 150,000 in total);
- ❖ exemption from w/h tax on interests paid on medium-long term loan granted by EU banks, insurance companies or institutional investors resident in white list countries and subject to regulatory supervision;
- ❖ a relevant downsizing of the deemed deduction on equity increases (so-called "ACE") applicable from 2017;
- ❖ a new rule applicable to carried interest paid from April 2017, which is deemed to be taxed as income from capital and/or capital gain if certain conditions are met.

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?

Italian tax authorities are monitoring the BEPS Action Plan and some specific recommendations have already been introduced into Italian laws, like e.g.:

- ❖ obligation of the country-by-country reporting for Italian multinationals (over 750 million euro 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 "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 occurred 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 imply facts, actions and agreements that are unable to 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 the improving of 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.

Further, the GAAR establishes that no criminal consequences apply if transactions are deemed as abusive.

As regards Action 6 on treaty abuse, there is not yet any tax law changes or drafting in new treaties incorporating the related BEPS concepts. In Instructions n. 6/E issued 30 March 2016 the Italian tax administration analysed various tax issues related to leverage buy-outs and private equity deals, including the use of foreign companies with a light organisational structure or with a conduit financial structure and affirmed the principle that, in case of artificial structures, the application of tax treaty benefits may be refused and domestic rules can be applied.

As regards Action 15 Italy has participated to the working group which has drafted the OECD Multilateral Instruments amending the tax treaties and should be going to sign its final version.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Such transactions regard the transfer of shares or quotas of a company which owns the business to which the purchaser is interested in. The transaction may regard an existing company or a new company in which the relevant perimeter of the business is preliminarily 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 tax 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.
- ❖ The share deal is not subject to indirect taxes, except in case the shares sold regard an Italian joint stock company (“società per azioni”) when 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 limitation period, i.e. 31.12 of the fifth year following the filing of the tax return for 2016 onwards (for tax periods 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 for guaranties of the tax risks.



- ❖ In a share deal, in principle there is no step up of the assets value unless certain extraordinary transactions are realised and/or a specific option is exercised which imply the payment of a substitute tax.
- ❖ The perimeter of the deal could not correspond to the assets/liabilities of a company and therefore a preliminary carve out into a specific company may be needed and this 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 leave in principle to the seller the possibility to apply the participation exemption regime on the subsequent sale of the new shares.

B. Asset deal

Such transaction regards 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 relevant values, i.e. it implies a step-up also 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 not deducted interests) 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 could not be possible due to rules on “trade” of 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 transferring 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 and anyway for 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 asked to the tax authorities and the buyer’s liabilities are limited to those resulting from it. The said 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 case of assets owned by more than three years, the gain may be deferred over maximum five tax periods) and is not subject to IRAP if the asset deal regards 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 are present; the transfer taxes are paid usually by the buyer, even if 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 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 (disavanzo di fusione - 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 fixed assets tangible and intangible received by paying a substitute tax at the rate of 12% on the portion of the step-up in value up to EUR5 million, 14% on the portion of the step-up from EUR5 million to EUR10 million, and 16% on the portion of the step-up in value exceeding EUR10 million. The option for the step-up can be elected in the tax return of the year in which the merger has been done or in that of the following tax year. The step-up tax values are effective starting from the fiscal period in which the option is exercised, subject to a recapture rule if the assets are disposed within the fourth fiscal period following the one in which the option is exercised;
- b) according to special provisions, the step up may regard the tax value only of intangible assets (goodwill, trademarks and other intangible assets) by paying a substitute tax at the rate of 16% and obtaining a shorter depreciation period (5 years) for goodwill and trademarks instead of the ordinary period (18 years). This regime can be applied in the same periods and with the same recapture rules than a);
- c) moreover, the absorbing company can optionally step up the tax value of assets other than the fixed assets by paying ordinary taxes or, in the case of a step-up of receivables, by applying a substitute tax at a rate of 20%.

Finally please note that, even without any merger with the target, if the Italian acquiring company includes the target in its consolidated accounts and attributes in such accounts the price paid also to intangibles assets; a 16% substitute tax can be optionally paid on such amount and the step up tax effects described under b) above are applicable.

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

From an accounting viewpoint the goodwill paid in a transfer of a going concern (asset deal) can be amortised over its useful life, as properly motivated in the accompanying notes or, if such life cannot be reliably estimated, within maximum 10 years. For tax purposes, the goodwill must be anyway amortised in not 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 of the goodwill can be reduced to not less than 5 fiscal periods, irrespective of its accounting depreciation.

Please note also that trademarks are treated for tax purposes exactly as the goodwill (both in ordinary and special regimes).


6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

According to Article 96 of the Italian tax code net interest expenses (i.e., interest expenses less interest income) are deductible up to an amount equal to 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) as shown in the profit and loss statement. From 2016 onwards also dividends received from foreign controlled companies are included in the above EBITDA computation.

Interest expenses exceeding the 30% EBITDA threshold are not deductible in the relevant fiscal year and are carried forward in the following fiscal years (without any time limit) and may be deducted in a subsequent tax period if and to the extent the 30% of EBITDA is higher than net interest expenses in that fiscal year. If the 30% EBITDA exceeds net interest expenses, such exceeding EBITDA can be carried forward to offset in the future exceeding interest.

Excessive interest can be offset within a domestic fiscal unit in computing the total income within the group if (and to the extent) other companies within the group have their own 30% EBITDA exceeding their own interest expenses.

In a merger or a demerger, excess interest carried forward is subject to the same limitations imposed for 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) interests are fully non deductible.

The described regime is not applicable to companies operating in banking, finance, insurance and other particular industries listed by the law, for which from 2017 interests are fully deductible for both income taxes (IRES and IRAP); previously a specific rule allowed deduction of only 96% of interest expenses accrued both for IRES and IRAP.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 expenses accrued on it are utilised 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 the Newco's tax position.

In Instructions n. 6/E of March 30, 2016 the tax authorities have analysed various tax issues regarding leverage buy-outs, confirming that:

- ❖ in principle such transactions (and the tax deductions of interests paid) cannot be challenged under the "abuse of law" discipline, unless in special cases of artificial structures, like when the buyout structure is put in place by the same subjects 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 like an intercompany service provided by such entities to Newco and subject to transfer pricing rules;
- ❖ the tax authorities may recharacterise shareholder loans into equity funds according to OECD Guidelines if, on the basis of the specific facts and agreements, the economic substance of the transaction is not that of a financial debt; as a consequence interests paid would not be tax deductible but the recharacterised amount would give rise to the deemed deduction provided by 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 dividends are taxable only on 5% of their amount.

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 realised after 2010 (equity contributions and undistributed profits less reductions of equity with attribution to shareholders).

Anti-abuse rules may reduce the ACE basis in case of intercompany transactions like investments in controlled Italian companies, acquisition of participations or going businesses from Italian group companies, increase of intercompany loans to Italian group companies as compared to 2010 and also increase of investment in securities other than participations and other cash items as compared to 2010.

The rate applied in computing ACE benefit was 4.75% until 2016 and it is now reduced to 1.6% for 2017 and to 1.5% from 2018 onwards.

Please note that ACE deduction not utilised can be carried forward without time limit or used to offset IRAP tax; ACE deduction not utilised can be also surrendered to the domestic fiscal unity.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

In principle tax losses can be carried forward without any time limit but can be used to offset the taxable income only within a threshold equal to 80% of the yearly taxable income.



Limitations to the carrying forward of tax losses should apply when the following conditions are both met:

- ❖ the majority of the voting shares in the company that is carrying forward losses is transferred, and
- ❖ the main activity carried on by the company is changed from the one carried on in the fiscal years when losses were suffered. The change in the activity has to occur in the year the shares are transferred or during the previous two 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 exceeds in the profit and loss statement of the previous year certain thresholds (“vitality test”).

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 respected and up to 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 until 2015 the period can still be doubled if there has been any prior communication to a public prosecutor (irrespective of which is the course of the criminal proceeding).

In case of tax losses or exceeding interests to be carried forward, it has to be evaluated the impact of the rules which may limit the subsequent use of such tax attributes.

Also transfer pricing issues have to be considered since frequently tax audits regard such issues. It should be checked if the company had proper TP documentation according to Italian TP rules since this will prevent the application of penalties in case 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 here subject to taxation.

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

In a share deal, a stamp tax is applicable at a 0,20% rate in case of transfers of shares of joint stock companies (“società per azioni”) even if executed outside financial markets.

In an asset deal, indirect taxes depends upon the type of transaction:

- ❖ in case 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%;
- ❖ in case of the transfer of an isolated asset (i.e., not a business as a going concern), if the seller is a VAT-taxable person the transactions would be likely subject to VAT.

In terms of financing acquisitions, any bank loan which lasts for more than 18 months and is granted by an Italian bank could be optionally subject to a 0.25% substitute tax (imposta sostitutiva) applied on the amount of the loan. This tax substitutes 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 case of a share deal, the costs directly related to the participation acquired have to be capitalised as ancillary cost of the participation (and therefore 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 duration of the financing (subject to the same limitations of the interest paid).

In case of a leveraged buyout the deduction of the costs related to the acquisition may be challenged by the tax authorities in particular if such costs are charged by the same private equity firm; if in this case the fees charged represent a service deemed to be in the interest of the private equity firm or of the investors (instead of the portfolio company), it can be challenged the deductibility of such costs for lack of inherence of the said costs.

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 art. 4 of Italian VAT Law no VAT can be deducted if the acquiring company is an holding company operating without any direct structure aimed at exercising financial activities or other activities of direction and coordination or management activities in the participated companies. If instead the holding actively intervenes in the management of its participated companies, it may be deemed to exist the said link with the VAT output transaction and therefore VAT paid may in principle be recovered.

According to Instructions n. 6/2016 the same principles apply also in a merger leveraged buy-out where the VAT recoverability should not be allowed if the acquisition company is not involved in the management of the target.

In case of an asset deal, VAT paid on acquisition costs is in principle deductible from VAT due, unless the going concern exercises a VAT exempt activity.

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

For foreign shareholders it is relevant the taxation on repatriation of profits and on capital gains at exit.

Dividends paid outbound are subject to a 27% w/h tax, unless in the following cases:

- ❖ zero w/h tax in cases where the EU Parent-Subsidiary Directive 435/90/CE is applicable (i.e. an EU parent company has held at least a 10% stake for one year in an Italian subsidiary company);
- ❖ a 1.375% (reduced to 1.20% for distribution of profits earned from 2017 onwards) w/h tax on dividends paid to UE companies or to companies of the European Economic Area giving 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 signed by Italy.

In terms of exit, the capital gain realised by a foreign company selling shares of an Italian target is usually protected from taxes in Italy according to the applicable tax treaty.

The already mentioned Instructions n. 6/2016 clarified that the application of the above rules on dividends and capital gains should be carefully monitored in case the foreign company does not have sufficient substance requirements or is a conduit (as better described in Section 20).

Moreover, the payment of dividends/interests/royalties from Italian companies to foreign holding/finance company usually requires that the foreign company is the beneficial owner of the payments in order to apply reduced rates also according to the tax treaties.



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

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, a deferral of capital gains taxation is allowed and the acquiring entities receive a carryover basis in the assets acquired.

In case of transactions which allow the transfer of the tax attributes (like mergers and de-mergers) particular attention has to be devoted to the limitation rules (described in Section 9) which apply to tax losses and exceeding interests to be carried forward.

The main caveat to tax-neutral restructurings is the new rule regarding the “abuse of law” (art. 10-bis of Law n. 212/2000) which is applicable to transactions lacking of economic substance which realise undue tax benefits and that can be consequently disallowed by the tax administration.

Taxpayers may ask for a ruling to determine if the transactions that they are about to carry out may constitute abuse of law. No criminal charges would be linked to the “abuse of law” behaviour.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

In case of a share deal it has to be taken into account that the favourable participation exemption regime for the selling company (see Section 17) 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 having the value of its assets mainly represented by real estate at any time during the last three fiscal year before the shares are sold. Properties used for the purpose of a commercial activity are not deemed to be real estate assets for capital gain purposes.

In case of an asset deal made by a VAT subject, the sale of a commercial real estate is VAT exempt or, by option of the seller, is subject to ordinary VAT with the reverse charge system; anyway a 3% cadastral and a 1% mortgage taxes are due in such case (reduced by half if a real estate fund is part of the transaction).

In case of a sale realised by a non VAT subject, the sale is subject to registration tax at 9% rate in case of a commercial building and 12% in case of agricultural land (cadastral and mortgage tax are applied for a fixed amount of 200 euro each).

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

The tax system provides for various group regimes like domestic fiscal unity or world-wide fiscal unity. The benefits of such regime regard (i) the offsetting of income and losses of the various companies for corporate income tax purposes since IRES is only applied on a consolidated basis, (ii) the surrender to the fiscal unity of certain tax attributes not used by the single company (like ACE, 30% EBITDA exceeding net interests, etc.) and (iii) the non application of tax losses carryforward rules in mergers between consolidated entities.

In case of companies owned by other companies with shareholdings ranging between 10% and 50%, it can be exercised the option for the fiscal transparency regime so that the participated entity is not taxed for IRES purposes and its income /loss is transferred proportionally to the shareholders and taxed therein.

All the above regimes regard only corporate income tax (IRES) whereas local income tax (IRAP) remains applicable on a stand-alone basis.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Italian companies are entitled to the 95% participation exemption (i.e. only 5% of the capital gain is subject to IRES tax) if the following requirements (under Article 87 of the Italian tax code) are met:

- a) the shareholding has been held at least from the first day of the 12th month prior to the disposal;
- b) the shares have been booked by the seller as a long-term investment (fixed financial asset) in the first balance sheet of the holding period (no minimum percentage is required);
- c) the participated company is not resident of a tax haven;
- d) the participated company is exercising a real business activity (e.g. other than real estate companies or intangible portfolio companies).

The above requisites under lett. c) and d) must be fulfilled starting from the beginning of the third fiscal period prior to the sale.

Lacking any of the above conditions, the capital gain is fully subject to IRES corporate income 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.

For individuals resident in Italy, the taxation of capital gains in Italy depends on the level of shareholding, as follows:

- ❖ “qualified” participations, 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 at the stock exchange and respectively 2% and 5% if the company is listed; in such case the capital gain is subject to personal tax (maximum tax rate of 43% for income exceeding EUR75,000 and 46% over EUR 300,000) only for 49.72% of its amount (i.e., 50.28% exempt);
- ❖ “non-qualified” participation, the capital gain is instead subject to a 26% substitute tax.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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 the exemption of the capital gains realised upon the disposal of both qualifying and non-qualifying participations in stock companies and partnerships, provided that:

- ❖ the participated 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 borne by the company to which the transferred shares refer during 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.

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

Although no specific substance requirements are provided by the law, great attention is dedicated by the tax authorities in reviewing the real substance of foreign holding companies and in some cases to apply the tax presumptions according to which a foreign company may be deemed to be tax resident in Italy.

In Instructions n. 6/2016 the tax authorities clarified that they may apply full domestic w/h on dividends or disallow the tax treaty exemption on capital gains if foreign intermediate holding companies have:

- ❖ a light organisational structure, not performing a real activity and without any decisional autonomy from a substantial view point; or
- ❖ a conduit financial structure regarding the transaction, in which it is all organised to have a substantial correspondence between what is cashed in and out of the company.

Finally please note that in certain cases foreign companies may be deemed to be tax resident in Italy. In fact 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 is mainly formed by Italian resident individuals.

21. 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 a going business into 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 of full neutrality since:

- ❖ for the receiving company the tax cost of the assets received remains the same of 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 anyway decide to optionally step up the assets also for tax reason by applying the substitute tax provided by the optional regimes described in Section 4.

The contributing company may subsequently sell the Newco shares to a third party by applying the participation exemption regime (even before the one year minimum holding period if the going concern were held by more than that) and get the 95% tax exemption on the taxable capital gain. Such contribution in kind followed by the sale of Newco shares is explicitly ruled by the law as 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 (EUR200) 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 offices often try to recharacterise the transaction as a sale of a going business in order to apply proportional taxes. A final position of the jurisprudence on such tax assessments has not yet been finalised.

As regards mergers and de-mergers, please note that they provide a full neutrality both for an income tax point of view and for indirect taxes.



MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

As regards stock grants offered to the generality or categories of employees, there is a limited exemption up to an annual value of EUR 2.065,83 and an holding period of 3 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 for the manager.

According to Decree Law n. 50/2017 there are new rules on “carried interests” earned by employees or directors of companies or funds. Income deriving from shares, quotas or other financial instruments will be taxed as dividends or capital gains in case of a sale and therefore it 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 investment of the fund or of the equity of the company;
- ❖ the shares, quotas or financial instruments should earn income only after the income attributed to other shareholders has remunerated the invested capital and a certain hurdle rate; the same applies in case of sale of the said securities;
- ❖ shares, quotas of financial instruments are 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 an 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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JAPAN



JAPAN

INTERNATIONAL DEVELOPMENTS

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

Spin-off, i.e. a corporation creates a spin-off by distributing 100% of its ownership interest in that business unit as a stock dividend to existing shareholders, has been actively implemented in the US and some other jurisdictions. However, it has not been implemented in Japan, due to the stringent requirements for the tax free spin-off. However, the 2017 tax reform revises the relevant rules and it is expected by the Ministry of Economy, Trade and Industry that the spin-off will activate the business reorganisations and consequently M&A. The tax free requirements under the new rule are described below.

1. Existing shareholders will receive shares in a spin-off company which numbers are in proportion to their numbers of shareholdings in the parent company and they will not receive anything else.
2. There is not any majority shareholder of the parent company and it is expected that there is not any majority shareholder of a spin-off company.
3. Major assets and liabilities of a business unit will be transferred in connection with a transfer of that business unit.
4. It is expected that approximately 80% or more of employees of that business unit be continuously employed by a spin-off company.
5. It is expected that a spin-off company will continue to engage in that business unit.
6. It is expected that a director or an important employee of the parent company will become a specified director of a spin-off company.

(This rule will apply to transactions taking place on or after 1 April 2017.)

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 per BEPS Action 6, the Ministry of Finance expressed its intention on 26 May 2016 to cope with it by stating that since the conventional global standards such as the Model Tax convention and TP guideline are not properly responding to the business models of multinational enterprises in these days, efforts have been made to revise the global standards in order to properly impose taxation reflecting "Creation of Value". Japan has been revising double tax treaties with several jurisdictions in past a few years.

As per BEPS Action 15, Japan is one of many jurisdictions which have concluded negotiations on a multilateral instrument (MLI) that "will swiftly implement a series of tax treaty measures to update international tax rules and lessen the opportunities for tax avoidance by multinational enterprises." in the end of 2016.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

- ❖ Net operating losses carryover continues with the acquired corporation, but there is an exceptional case described in “tax disadvantages” below.

Tax disadvantages:

- ❖ The basis in the underlying assets of the target company carries over and is not stepped up at the acquired corporation.
- ❖ An intended carryover of net operating losses may be suspended in an example case described below.
 - 1) Target incurred tax losses in past years, thus it has a certain balance of carryover losses (“Subject tax loss carryover”) as of the year end 2017.
 - 2) M&A takes place on 15 April 2018.
 - 3) If a certain specified event (typically, starting a business which is new for Target) would take place during the period between 15 April 2018 and 15 April 2013 (5 years), the Subject tax loss would be cancelled. Therefore, if the specified event would take place in January 2019, the Subject tax loss carryover will not be able to be used for FY 2019 and thereafter.

B. Asset deal

Tax advantages:

- ❖ The basis in the underlying assets of the target company can be stepped up and any further appreciation gain (“Goodwill”) can be recognised and depreciated over 5 years.
- ❖ There will be no taxation at the level of shareholders of the target company (deemed dividends distributions and capital gain on shares), unless the target company will be liquidated.
- ❖ If shareholders in the target company wish to receive shares in the acquiring company (or its parent company which shares may be listed such as in Tokyo and NY Stock Exchange) as the consideration of a deal, a tax free merger (the joint venture type merger) between the target company and the acquiring company can be consummated.

Tax disadvantages:

- ❖ There will be two levels of taxation, if the target company will be liquidated after M&A, namely once at the target company’s level and then at the shareholder’s level.
- ❖ Net operating losses carryover of the target company will not be succeeded by the acquired corporation, except for certain cases where shares of the acquiring company rather than cash are given as the consideration.



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 case of acquiring shares of the target company, the fiscal identity of the target company is not changed. As such, the tax basis of assets and liabilities will not be stepped up.

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

In the asset deal in which the substance of a business is transferred, if the consideration paid would exceed the fair market value of net assets acquired, the excess portion (effectively “goodwill”) would be amortised over the 5 years period. The same rule applies to taxable mergers, taxable de-mergers and taxable contributions in kind.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

In general, a deduction is allowed for interest paid or accrued on legally valid indebtedness of the taxpayer. However, some provisions may limit the deduction. Major limitations are highlighted below.

- ❖ **Transfer Pricing:** Very broadly, Interest expense paid or payable to a related foreign party over the arm's length basis is not deductible.
- ❖ **Thin Capitalisation:** Very broadly, in case where the debt / equity ratio exceeds 3 to 1, an excess portion of interest expense paid or payable to overseas related parties. The interest expense hereby includes guarantee fees and securities lending fees.
- ❖ **Earnings stripping:** In general, the rule prohibits a corporation from deducting the interest paid or payable to a related foreign party to the extent its “net interest expense” exceeds 50% of the corporation’s “adjusted taxable income” as those terms are defined by the Corporate Tax Law. Interest in excess of this 50% limit can be carried forward the following 7 years.

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

Typically, from a Japanese standpoint, in order to push down debt on an acquisition, a new local holding company is established to borrow a debt and carry out an acquisition of shares of the target company, and thereafter, the target company is merged into the holding company so that interest on the debt can be relieved against the target company's profits. Alternatively, a local holding company and the target company may jointly file a consolidated tax return.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There is not any direct tax incentive for equity financing, but the Thin Capitalisation (mentioned in section 6 above) causes an indirect incentive.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

In case of share deals, net operating losses carryover should continue with the acquired corporation, but there is an exceptional case as a hypothetical example case described below, in which case, net operating losses carryover would be cancelled.

- 1) Target incurred tax losses in past years, thus it has a certain balance of carryover losses (“Subject tax loss carryover”) as of the year end 2017.



2) M&A takes place on 15 April 2018.

3) If a certain specified event (typically, starting a business which is new for Target) would take place during the period between 15 April 2018 and 15 April 2013 (5 years), the Subject tax loss would be cancelled. Therefore, if the specified event would take place in January 2019, the Subject tax loss carryover will not be able to be used for FY 2019 and thereafter.

In case of asset deals, net operating losses carryover of the target company would not be succeeded by the acquired corporation, but if shares of an acquiring corporation are offered as the consideration and the target is absorbed by the acquiring corporation by means of the merger for the purposes of joint venture business, net operating losses could be succeeded by the acquired corporation.

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

- ❖ Review of the net operating loss carryover as it is subject to various limitations.
- ❖ Review of the withholding tax on license payments in order to confirm whether the payment is for use of the copyright (taxable) or for the use of copyrighted products (non-taxable).
- ❖ Review of entertainment expenses as they are subject to limitation on deduction.
- ❖ Review of director's remuneration as it is subject to limitation on deduction.
- ❖ Review of Consumption Tax (VAT) procedure, as the Japanese system is unique in comparison with the European system.

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

There is neither stamp duty on a contract of transferring shares nor transfer tax on a transfer of shares.

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

Generally, expenses incurred in connection with receiving services such as professional advisory services are tax deductible as services are completed. However, expenses related to the acquisition of an investment which are capital in nature are not tax deductible immediately. Costs in regard to failed acquisitions are in principle immediately deductible.

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

In case of asset deal, transfer of assets is subject to VAT (i.e. Consumption Tax in Japan). Target charges VAT in invoicing to the acquirer corporation, but the acquirer corporation should be able to claim credits or otherwise refund of VAT paid. Transfer of shares in case of Share deal is not subject to VAT.

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

Dividends distribution: Dividends are subject to the withholding tax at the rate of 20.42%. However, the tax may be exempted or reduced by virtue of a Double Tax Treaty (e.g. US and the Netherlands).

Transfer of shares: In principle, there is not capital gains taxation, unless foreign companies have Permanent Establishments (PE) in Japan. However, there will be capital gains taxation at the rate of 25.81% in the cases described below.



a) Quasi transfer of business

It is a case where (i) a shareholder (including its related parties) owns 25% or more shareholdings in a Target company at any time during a year in which a transfer of shares takes place and the two precedent years, and (ii) the said shareholder (including its related parties) transfers 5% or more shareholdings in the Target company during the year.

b) Quasi transfer of real estate

It is a case where a Target company owns real estate which amounts 50% or more of the amount of its total assets. However, the taxation may be exempted by virtue of a Double Tax Treaty (e.g. the Netherlands and Switzerland).

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

A group may reorganise after an acquisition in a tax free manner through mergers. However, operating loss carryovers may be forfeited upon a tax free merger, for example, in a case where after forming a domestic holding company which acquires shares in the target company, the target company is merged into the holding company. This would be an effective procedure to push-down the debt to the business of the target company, however, net operation loss carryovers of the target company, if any, would be forfeited.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

In principle, foreign companies are not taxed in Japan on gains from the sale of a corporation's stock, unless foreign companies have PE in Japan. However, there will be capital gain taxation at the rate of 25.81% in the case of the quasi transfer of real estate, i.e. the sale of a stock of corporation which owns real estate which amounts 50% or more of the amount of its total assets.

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

The benefits the fiscal unity (the consolidated tax return) regime may grant are summarised below:

- ❖ Taxable profits of a group company and losses of another group company can be set off.
- ❖ Net operating loss of a parent company in a group can be used to set off against profits of subsidiary companies in the group.
- ❖ Dividend distributions are fully tax exempted within a group.
- ❖ Limitation of tax credits can be increased.

The benefits the tax grouping regime may grant are summarised below:

- ❖ Taxable gain and loss on transfer of certain assets such as fixed assets, land and marketable securities (not including Inventories) within a group are deferred.
- ❖ Dividends distributions are fully tax exempted within a group
- ❖ Distribution in kinds and a transfer of shares to its issuing corporation are consummated on the tax free basis.

It should be noted that the tax grouping regime is mandatory while the fiscal unity (the consolidated tax return) regime applies by a taxpayer's election.



SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

For a corporate taxpayer, capital gains are subject to the regular tax which maximum effective tax rate is 33.80%.

For an individual taxpayer, capital gains on disposal of shares are subject to tax at the rate of 20.315%.

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

There is no specific advantage, e.g. rollover relief, to reinvesting the proceeds of a sale of shares.

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

From a Double Tax Treaty standpoint, the tax treaties Japan has entered with US, UK, France, Australia, the Netherlands, Switzerland, New Zealand, Sweden and Germany contain the Limitation of Benefits clause and it effectively stipulates the substance requirement for the tax exemption on dividends as described below.

“Trade or business in country of residence is other than that of making or managing investments for the resident’s own account” and “Income derived from Japan is the income which is derived in connection with or is incidental to that trade or business in country of residence.”

From the CFC standpoint, the substance requirement is the capacity as the regional headquarters and it must have at least a fiscal office and its own management capacity.

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

Upon a merger, a liquidating company and shareholders of a liquidating company are principally subject to tax on an appreciation gain realised by a merger.

For a tax-free merger, it would be relatively easy to consummate it within a group company, but not easy in case of a merger between unrelated parties.

A merger for the purpose of conducting joint venture activities would be an approach for a tax-free merger, which requirements are outlined below.

- 1) It is expected that 80% or more of the employees of a liquidated company will engage in a business of a surviving company.
- 2) It is expected that the main business of a liquidated company will be succeeded by a surviving company.
- 3) One of the businesses of a liquidated company is related to one of the businesses of a surviving company.
- 4) (a) Sales, number of employees and capital amounts do not differ in more than five times between a liquidated company and a surviving company, or (b) it is expected that some of the management team members of a liquidated company and of a surviving company will remain after the merger.
- 5) It is expected that 80% or more of the shareholders of a liquidated company will continuously own shares in a surviving company distributed at the merger (this requirement applies if the number of shareholders of a liquidating company is less than 50).

A tax free merger is not subject to VAT.

A spin-off in the true sense which is comparable with a spin-off in other jurisdictions such as the US has not been implemented in Japan, due to the stringent requirements for the tax free spin-off. However, the 2017 tax reform



revises the relevant rules and it is expected by the Ministry of Economy, Trade and Industry that the spin-off will activate business reorganisations and consequently M&A. The tax free requirements under the new rule are described below.

- 1) Existing shareholders will receive shares in a spin-off company which numbers are in proportion to their numbers of shareholdings in the parent company and they will not receive anything else.
- 2) There is not any majority shareholder of the parent company and it is expected that there is not any majority shareholder of a spin-off company.
- 3) Major assets and liabilities of a business unit will be transferred in connection with a transfer of that business unit.
- 4) It is expected that approximately 80% or more of employees of that business unit be continuously employed by a spin-off company.
- 5) It is expected that a spin-off company will continue to engage in that business unit.
- 6) It is expected that a director or an important employee of the parent company will become a specified director of a spin-off company.

A tax free spin-off is not subject to VAT.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

The tax rules applicable to stock options granted to management are described below.

- ❖ **Grant of a stock option:** It is not a taxable event for management as well as for a corporation issuing the option.
- ❖ **Exercise of stock option:** Management is subject to tax as wage for a difference between the market value of shares and any amount contributed to a corporation. A corporation is able to deduct the cost of granting stock option.
- ❖ **Sale of shares:** Management is subject to tax on capital gains. It is not a taxable event for a corporation.

Taxation on management at the time of exercising the stock option may be deferred until the sale of such shares if the programme fulfills certain requirements provided by the Tax Law.

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KOREA



KOREA

INTERNATIONAL DEVELOPMENTS

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. However, if a transferee becomes an oligopolistic shareholder 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, no VAT is required in comprehensive asset transfer cases. 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 capitalisation 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 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.

CbCR has been added to the International Consolidated Report submission requirement enacted around December 2015 (previously, the AITA only required a consolidated corporate report and 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 Enforcement Decree (Article 21-2) was amended on 7 February 2017.



According to the Enforcement Decree, in principle, a domestic corporation which is the ultimate parent entity of a multinational enterprise group (MNE group) with sales exceeding KRW 100 billion according to its consolidated financial statements for the immediately preceding tax year must submit a CbCR. In the case of a MNE group with certain controlling shareholders located overseas, if the laws of the country where such controlling shareholders are located do not require CbCR submission or if there is no tax treaty between Korea and such country etc. whereby the CbCR can be exchanged, then the domestic subsidiary/branch of the MNE group must submit a CbCR.

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 of a MNE group must submit material related to the person obligated to submit the CbCR within six 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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. However, a transferee, a new shareholder, may undertake a reevaluation of the value of the tangible and intangible assets through legal procedures.

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

The term goodwill refers to the recognised 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 capitalisation approach, sales comparison approach and cost approach, and, in principle, such goodwill calculated by the said approaches is not amortised 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 amortisation within a period of five years.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

In share and asset acquisition cases, the thin capitalisation 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 USUAL STRATEGIES TO PUSH-DOWN THE 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 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 capitalisation 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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.

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 would be necessary to review statements of tax adjustments, status of tax payments, 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 analysed as well.

For instance, as corporate accounting based on K-GAAP and K-IFRS and tax accounting apply different standards, reviewing statements of tax adjustments will enable the verification of such differences. With regard to reviewing the status of tax payments, as this shows a history of tax payments made by a company, the status will show 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.

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 recognised 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, and such paid VAT may be recovered in certain cases.



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

The thin capitalisation 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

While a group may reorganise after an acquisition based on newly arising circumstances and tax considerations, a careful examination should be given taking into account benefits and costs thereof.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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. 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.

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

In the case of an asset deal, as an asset transfer gain will be calculated as corporate income of a transferring company, it will be subject to corporate tax. In the case of a share deal, a capital gains tax on share transfer gains must be paid. Moreover, there are differences in the calculation method of share transfer gains, withholding tax, tax rate, etc. depending upon whether the transferring company has a domestic permanent establishment.

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

There is no special benefit in respect to reinvestment other than the benefit for investment in general.

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

In principle, in cases of small and medium-sized enterprises, 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.]



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

A tax break relating to VAT, acquisition tax, etc. will be given to certain mergers/spin-offs recognised under the Commercial Act, tax laws, etc., and other matters such as amortisation of goodwill should be reviewed for tax purposes.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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.

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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?

- ❖ As part of its 2017 tax reform, Luxembourg introduced among others the following **Corporate tax changes:**
 - Corporate income tax (CIT) rate – a two-step decrease** – The CIT rate applicable to income exceeding EUR 30,000 is brought down from 21% to 19% in 2017 and finally to 18% in 2018. Taking the Municipal Business Tax (MBT) and the solidarity surcharge into account, it brings the global corporate tax rate applicable to companies in Luxembourg-city from currently 29.22% down to 27.08% in 2017 and 26.01% in 2018
 - Minimum net wealth tax (NWT) increased** – The minimum NWT applicable to SOPARFIs (holding and financing companies) amounting currently to EUR 3,210 has been increased 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 DIRECTIVES?

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

Based on the Luxembourg law implementing this directive and related administrative circular, the first CbC reports will have to be filed by 31 December 2017 at the latest and the Luxembourg tax authorities had to be notified of the identity and tax residence of reporting entities by 31 March 2017 at the latest.

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 24 November 2016, more than 100 jurisdictions, including Luxembourg, have adopted the text of the multilateral instrument that will implement some of the BEPS recommendations into more than 2,000 tax treaties worldwide. Luxembourg is expected to sign the MLI at the signing ceremony which will be held in June 2017 in Paris.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 AMORTISATION 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 ON BORROWINGS 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 formalise 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, formalises 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 of intra-group financing activities. The new circular follows 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 as dividend 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.

Finally, the Luxembourg government has not announced yet the way it will implement the interest deduction limitation rule provided in ATAD. However, as soon as those rules will be in place in Luxembourg, additional limitations to the deductibility of interest expenses will apply.



7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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
- ❖ Transfer pricing studies prepared 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 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 realised 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 was generated by the expenses.

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

Within the framework of M&A transactions, 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 BY FOREIGN COMPANIES?

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 6 months or less
- ❖ 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 continue 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 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) where the absorbing company holds a qualifying participation of 10%, or has an acquisition value of at least EUR 1.2 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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. This income might either be considered as capital gain or as real estate income and thus 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. Even though the income of the company might be exempt by application of such rules, a minimum amount of corporate income tax will be payable according to the principles mentioned under question 1 above.

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 realises a profit and only up to the amount of profit realised 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.

SELL-SIDE

18. 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 27.08% (26.01% as of 2018) in Luxembourg. 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
- ❖ A Luxembourg resident capital company fully liable to Luxembourg tax
- ❖ A non-resident company liable to a tax corresponding to Luxembourg corporate income tax

For that purpose, a taxation of at least 9.5% (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.



19. 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. the benefit of the participation exemption regime.

20. 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.

21. 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 2 Luxembourg companies should be considered as a deemed liquidation of the absorbed company and as such should trigger the realisation 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
- ❖ 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Capital gains realised 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 and the sale is performed more than 6 months following the acquisition of the shares. Capital gains realised by Luxembourg resident managers on the sale of shareholdings are exempt under the same conditions. In addition, 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 ($\frac{1}{2}$ of the applicable income tax rate - Maximum of 22,89% for 2017).

The remuneration of the managers may also be structured through the implementation of a stock option plan which benefits from an attractive income tax regime.

Luxembourg provides an attractive tax regime for highly skilled employees who are expatriated to Luxembourg. This regime allows the employer, under certain conditions, to deduct in part or in full the costs the employer will have to bear in relation with the change of residence of its employee. At the level of the employee, these expenses are not treated as an additional remuneration and benefit therefore from an income tax exemption.

Following the publication of Circular n°781 on 30 September 2016, the Luxembourg VAT authorities confirmed that director services constitute an economic activity and that Luxembourg based directors have to be considered as VAT taxable persons, irrespective of whether the director is a company or a private individual. As a rule, VAT at the rate of 17 % is therefore applicable to director services located for VAT purposes in Luxembourg. Some exceptions to the application of the VAT exist (management of funds, honorific activity, etc.).

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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?

Please see 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 DIRECTIVE?

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).

At present, the Ministry of Finance and the Malaysian Inland Revenue Board have not provided further details on the implementation of these 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 have been issued by the Ministry of Finance in December 2016. 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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.



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.

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 IN YOUR COUNTRY?

Malaysia does not have any particular rules for amortisation of goodwill. Goodwill is not tax deductible and does not qualify for capital allowances.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Interest expense 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.

Under the thin capitalisation rules, interest that is deemed excessive in relation to the fixed capital of the company will be disallowed as a deduction. However, the implementation of this rule has been deferred until 31 December 2017.

Interest on loans from related parties should be charged at an arm's length basis under the transfer pricing rules.

It should be noted that payment of interest to non-resident lenders is subject to withholding tax.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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

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 qualifying plant expenditure.

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

Transfer of shares is not subject to GST. However, GST will be applicable on the sale of assets in which case, the acquiring company would be able to claim the input tax, unless the asset is used by the acquiring company to make an exempt supply. The sale of business as a going concern is not subject to GST.



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

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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. Transfers of fixed assets between related companies are subject to the control transfer provision, as explained in question 3.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.

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

There is no fiscal advantage if the proceeds from the sale of shares are reinvested.

20. 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.

21. 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. Likewise, transfer of a business as a going concern, subject to meeting certain conditions, will not result in any GST payable.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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?

Malta is not a country which changes its income tax legislation very often and in recent years there have been no major or significant changes to the income tax legislation which are relevant to the M&A deals and which merit any special attention. Changes to the income tax legislation and subsidiary legislation are often a result of budget measures with a view to increase foreign direct investment (on which the Maltese economy depends quite heavily) or else driven by 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 OECD BEPS actions. However, since Malta is a Member of the European Union it has amended the tax legislation to implement the amendments relating to the anti-abuse provisions of the EU Parent Subsidiary Directives.

Also, as an EU Member State, Malta is bound to adopt and implement EU Directives including the EU Anti-Tax Avoidance Directive (EU Council Directive 2016/1164) which contains some of the BEPS Actions.

Malta does not have any Controlled Foreign Company (CFC) legislation or rules or exit taxation but the other measures contained in the Anti-Tax Avoidance Directive, namely, switchover rule, interest limitation and general anti-abuse rules or measures, are already found in the Maltese tax legislation.

Also, Malta has fully implemented the automatic exchange of information (including that on advance revenue rulings) and the Country-by-Country Reporting (CbCR) as a result of the EU Directives.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

The purchase of assets through a share acquisition may be subject to duty on documents (commonly referred to as stamp duty). However, exemptions from duty on documents apply if the company has more than 90% of its business interests / activities outside Malta. If the share transfer is not exempt, then the duty on documents is computed on the market value of the shares. The market value is usually taken to be the net asset value 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 EUR 2 on every EUR 100 of the market value, with the rate being EUR 5 on every EUR 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 as long as 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 to be a group and enable the transfer of trading losses between companies. The surrendering of trading losses must be made within the same tax year. Therefore, any losses 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 and thus applies the anti-abuse provisions. 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, a cross-border merger as well as the change in a company's tax residence by moving the effective management and control of a foreign incorporated company it is also possible to have a step-up in the value of assets held by the company.

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 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 considered to be 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 who opt to re-domicile to Malta or companies resulting from a cross-border merger are entitled (but not obliged) to claim a step-up in the tax base cost of assets situated outside Malta without any adverse Maltese tax consequences.

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.

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

Goodwill may not be amortised for income tax purposes. It is a non-deductible expense.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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. Therefore, 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 general rule, no distinction is made between intra-group debt and third-party lenders. However, intra-group debt may be subject to more scrutiny to ensure that such debt is at arm's length.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 of any existing loan. The tax legislation clearly provides that any interest payable on capital employed in acquiring the income is allowable for income tax purposes. 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?

No, there are no tax incentives for companies to finance their operations through equity rather than through debt. In some cases, financing through debt may be attractive since any interest expense may reduce the income brought to charge.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 is incurred.

Only trading losses may be surrendered to group companies. Any capital losses 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.

It is possible that the purchase and eventual merger of two companies may be viewed by the Inland Revenue Department as a scheme to utilise tax losses by the target company, in which case anti-abuse provisions will apply.

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 legislation contains a general anti abuse provision as well as some specific anti-abuse provisions that may limit tax deductions.

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 EUR 2 on every EUR 100 or EUR 5 on every EUR 100 of the market value of the shares. As pointed out above, exemptions from duty on documents apply if the company whose shares are being transferred has more than 90% of its business activities outside Malta. If no exemption applies, the market value of shares is computed on the basis of the company's net asset value, 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 for a deduction of expenses which are incurred in the production of the income. Acquisition costs are normally considered to be of a capital nature and therefore not allowable as an outright 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, motor vehicles etc.).

Pure holding companies 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 BY FOREIGN COMPANIES?

There are no adverse tax implications for foreign entities acquiring shares in a Maltese company. 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 exempt from duty on documents as well as 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.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

Exemptions from capital gains tax upon share transfers exclude companies which hold immovable property situated in Malta.

Transfer of immovable property is subject to property transfer tax at the rate of 8% applicable on the consideration / market value. Other property transfer tax rates apply in exceptional cases and range between 2% and 10%. Such tax is considered to be 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?

During the last budget, the Minister of Finance announced that legislation with respect to fiscal unity will be enacted however to date no drafts or details have been made available.

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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, trade-marks, 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%. 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%.

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 it 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 is considered to be 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;
- ❖ 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;
- ❖ 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;
- ❖ The Maltese company is an equity shareholder which invests a minimum of EUR 1,164,000 (or the equivalent in a foreign currency), and such investment is held for a minimum uninterrupted period of 183 days;
- ❖ 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;
- ❖ 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.

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

Rollover relief is available to companies that transfer an asset used in the business for at least three years and replaced within one year. Therefore, the sale of immovable property may not be brought to charge, but the original cost of the immovable property is reduced by the gain. Such relief defers the tax liability until the asset is disposed of and not replaced.

Anti-abuse provisions apply to minimise tax avoidance when an asset is replaced by another asset of a lower value than the original one.

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

Malta does not have any specific legislative requirements with respect to local substance as the basis of taxation for companies incorporated in Malta is on a world-wide basis, thus 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 residency of companies incorporated outside Malta. Indeed, a company is considered to be tax resident in Malta 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.

21. 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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.

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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?

The Mexican tax authorities have issued administrative regulations for the application of article 31-A of the Federal Tax Code (FTC), which obliges taxpayers to disclose certain relevant transaction information and restructures entered into by the group to such authorities.

Specifically, the relevant transactions disclosure return (or “DIOR” as per its acronym in Spanish) 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 exhibits: i) financial derivative transactions, ii) transfer pricing adjustments, iii) changes in shareholders and tax residence, iv) reorganisations and restructuring within the multinational group and v) other relevant transactions. The information requested in each section 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, centralisation or decentralisation of functions, and other practices that the tax authorities have identified as a risk of tax avoidance.

The Supreme Court, in an isolated case, has ruled such provision as unconstitutional as it creates legal uncertainty as it does not set clear criteria as to what are “relevant transactions” nor creates boundaries as to what information may be requested, but rather allows the tax authorities to arbitrarily request any information they see fit by means of a form which is only available through the tax authorities’ website. Although no other similar cases have been resolved, the tax authorities have issued a communication stating that they will look for an amendment of article 31-A to be able to enforce the filing of the DIOR.

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 the issuance of administrative regulations, have 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 as taxable income). Additionally, another provision was introduced into the law providing that 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.

Also as from 2014, legal requirements to obtain treaty benefits by Mexican residents have been strengthened in connection with 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.

Prior to BEPS, Mexico has had 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 extended to taxpayers that hold investments in transparent entities or through entities in black-listed jurisdictions.

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.

In recent tax treaty negotiations, Mexico has included PPT or LOB clauses to restrict treaty benefits in abusive situations.

In connection with 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, it is expected that Mexico will be an early signer and implementer of the multilateral instrument.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A) Share deals

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 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 nonresident 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 deals

Tax advantages:

- ❖ Step-up of the tax value of the assets for the purchaser.
- ❖ The cost of assets purchased may be deducted via depreciation by the purchaser 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 AMORTISATION OF GOODWILL 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 capitalisation 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-characterised as a dividend if the loan is considered to be a back-to-back loan, and non-deductible as such.

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 not a 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.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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. 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.

Alternatively, tax consolidation is used to optimise a group's tax burden utilising the deduction of acquisition debt interest (with the associated recapture of losses if the holding company did not individually generate sufficient profits to amortise 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 tax law 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 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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.

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 BY FOREIGN COMPANIES?

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 authorised 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 of 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 reorganisations 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 authorise 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 authorisation 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 authorise the corporate restructure before it is executed and the benefit of the authorisation is a deferral in the payment of the tax that would have been triggered without the reorganisation authorisation. 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 reorganisations (eg. United States, the Netherlands, Luxembourg, Hong Kong and Spain, among others).


16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 a direct 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 tax law, 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 that 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 realised had there been no integration will be deferred for three years and covered updated by inflation.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 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 recognised 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 restructures. Further, the tax rate on capital gains may be reduced 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.

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

There is no particular advantage or deferral benefit for reinvesting proceeds from sale.

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

There are no local substance requirements for foreign holding companies, nor any are envisaged after BEPS.

21. 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, authorisation 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.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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. In case of Mexican resident individuals, the 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.

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.

In this regard, stock option 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.

There are no special tax considerations in Mexico for management incentives, such as sweet equity or manager remunerations.

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THE NETHERLANDS



THE NETHERLANDS

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 recently agreed to sign the Multilateral Instrument (some observations were made, please refer to question 2). Furthermore, the innovation box regime has been changed to reflect the conditions set forth in BEPS Action 5. 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 (as sole requirement for SMEs).

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) need to be implemented. 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. The Anti-Tax Avoidance Directives I and II need to be implemented ultimately per 2019 (the earning stripping rule ultimately per 2024) and 2020 (the reverse hybrid mismatch rule per 2022) respectively. It is expected that a legislative proposal will be published for public comments in the course of 2017.


Moreover, the Dutch Ministry of Finance announced a potential amendment of the Dutch dividend withholding tax regime to equalise the Dutch dividend withholding tax treatment of cooperatives and NV / BV's. The proposed changes will broaden the scope of the Dutch dividend withholding tax exemption and are therefore a welcome improvement of the Dutch investment climate. Unlike NVs and BVs, cooperatives are in principle not subject to Dutch dividend withholding tax unless anti-abuse rules apply. Under this proposal, as per 1 January 2018, non-operational Cooperatives should in principle be subject to Dutch dividend withholding tax. Additionally, the scope of the dividend withholding exemption in Dutch tax legislation is likely to be 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 proposed changes will be. Mainly private equity investment structures with the use of entities in non-treaty jurisdictions such as Cayman Islands and investment structures with the use of Dutch holding cooperatives will be impacted.

In addition, further restrictions have been implemented with respect to interest deduction limitations. Changes have been made to (i) the general anti-base erosion interest deduction limitation and (ii) changes to the interest deduction limitation for leveraged acquisitions.

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 Multilateral Instrument. An anti-abuse rule countering the use of intermediate entities in non-treaty jurisdictions or intermediate entities with insufficient substance in the structure is also likely to be implemented in Dutch tax law following the recent announcement. There are furthermore on-going efforts to renegotiate tax treaties with developing countries in order to include an anti-abuse rule.

The Ministry of Finance in the Netherlands endorses this Multilateral Instrument although some reservations were made respect to (i) hybrid entities, (ii) the so called “saving clause”, (iii) with respect to splitting-up of contracts and (iv) mandatory binding arbitration. The Netherlands intends to implement at least the conclusions from BEPS



Actions 6 (treaty abuse), 7 (permanent establishments) and 14 (dispute resolution mechanisms) in its tax treaties via the Multilateral Instrument. As a result, the BEPS conclusions should be taken into account in the explanation of the double tax treaties concluded by the Netherlands with jurisdictions that also endorse the Multilateral Instrument.

The Multilateral Instrument is signed in June 2017 and will enter into force after the required ratification has taken place.

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). To what extent all rules will be implemented is not yet announced to date. It is however expected that all amendments will be implemented per 2019 (i.e. including the earning stripping rule). The EU Anti-Tax Avoidance Directive II needs to be implemented per 2020 (the hybrid mismatch rule per 2022). It is expected that a legislative proposal will be published for public comments in the course of 2017.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 AMORTISATION OF GOODWILL 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 capitalised and can therefore not be depreciated.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 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 for incurred 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. Recently new legislation has been introduced to the question of when parties are considered "related";
- 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 the 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 has 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. It is to date however uncertain how strict the Netherlands will implement this rule and whether any of the above mentioned anti-abuse rules will be abolished. A legislative proposal can be expected early 2018 (preceded by a public consultation at the end of 2017).

❖ Acquisition of assets

There are no specific rules on interest limitations for the acquisition of assets, besides the general concept of abuse of law. Please note that the implementation of the earning stripping rule may impact the acquisition of assets.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 can still be effectuated e.g. in case of third party financing (that is used to finance a dividend distribution). 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. However, the Ministry of Finance is reviewing whether it is possible and beneficial to equalise the tax treatment of equity and debt.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 be 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.

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 BY FOREIGN COMPANIES?

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 (a so called substantial interest).



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 dividend withholding tax or 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 harbour 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 shareholder/member in the jurisdiction of residence. Please refer to question 20 for an overview of the minimum Dutch substance requirements.

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).

These rules are heavily impacted by the expected amendments to the Dutch dividend withholding tax law as per 1 January 2018 and should be monitored.

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

Dutch law provides several facilities to reorganise 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 unrealised 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, generally, 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.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 reorganise in a tax neutral way, as transactions between companies belonging to the same fiscal unity are, generally, 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 proposed to gradually increase the lower bracket with the following steps: EUR 250,000 (2018), EUR 300,000 (2020) and EUR 350,000 (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.

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

In general, the taxpayer may defer taxation of the capital gains realised 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 realised 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.

20. 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.

Based on the envisaged amendments to Dutch tax law, it is expected that the current substance requirements for certain intermediate non-Dutch shareholders/members will be supplemented with two additional requirements: (i) a minimum amount (EUR 100k) of wages payable and (ii) having office space.

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

Dutch law provides several facilities to reorganise 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 reorganisation 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 reorganisation facilities may, under circumstances, also apply in cross border situations within the EU/EEA.

The reorganisation 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 reorganisation facility is only applicable under additional conditions and parties involved should file a request for the applicability of the reorganisation facility to the Dutch tax authorities. Please note that a reorganisation facility will not be granted if the reorganisation is not based on business reasons, such as a valid restructuring or rationalisation 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 reorganisation is based on sound business reasons. A denial of such request is open to appeal.

As a result of the reorganisation 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 reorganisation (e.g. a claw back may arise if the acquiring entity is sold within three years after the reorganisation 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 reorganisations (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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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. Preference shares which constitute less than 10% of the total share capital 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.

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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 since 2015 been reduced from 27% to 24% in 2017. It is expected that the tax rate will be reduced to 23% with effect from 2018.

The Ministry of Finance has recently proposed extending the scope of the Norwegian interest deduction limitation rule to also include interests to external parties. The proposed legislation implies that the deduction of interests paid also to non-affiliated loan providers may be denied for tax purposes if certain criteria are not met. The threshold for the interests covered by the legislation is set to NOK 10 million and the threshold is assessed at a group level. The ministry has proposed several exceptions in order not to disregard arrangements which are not tax motivated and artificial. The new rules are initiated by the OECD BEPS initiative. Please see question 6 for further information.

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 Norwegian government is generally positive with regards to the BEPS initiative, and will most likely follow up on most BEPS actions. Several of the BEPS actions have already been implemented (e.g. anti-hybrid rules, rules limiting the deductibility of related party interest costs). The suggested amendment of the existing interest deduction limitation rules are an example of this (BEPS action point 4).

As Norway is an EEA member, the EU Parent-Subsidiary Directive and the Anti-Tax Avoidance Directive are not applicable for Norway. However, Norway has implemented legislation which is similar to the legislation which is proposed in the directives, but there are several important differences.

Regarding Action 6 (prevent treaty abuse), Norway does currently not have LOB (“limitation of benefit”) or PPT (“principle purpose test”) clauses in most tax treaties to which it is a party. It is expected, however, that the government will implement such rules, although it is not yet clear whether it will go for both LOB rules and PPT rules. In any event such rules seems to be a part of Norway’s future tax treaty policy

Regarding Action 15 (multilateral instruments), Norway has participated in the negotiations and is expected to sign the MLI. The further content is however not clear.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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, thus, 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 free for corporate shareholders. Thus, a share deal will not have any (direct) tax consequences.

However, a tax loss carry forward in the target company may lapse if the main purpose of the acquisition of the shares is to get access to 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 are considered to be realised for tax purposes and capital gains are taxable at 24%. Losses are deductible. Because the asset deal is a taxable event a purchase price allocation of the assets must be prepared. The allocation will be the basis for the calculation of taxable gain/loss.

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 values of the tangible and intangible assets in a share deal.

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

Purchased goodwill (e.g. through an acquisition) is depreciable at the 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are rules limiting the deductibility of interest costs to related parties. Net interest costs, per entity, exceeding 25% of the tax EBITDA is not deductible, if the interest costs are considered as related party interest costs. Other interest costs are fully deductible, but will use up the available interest ceiling before related party debt. If the net interest cost, per entity, does not exceed NOK 5 million the interest costs are fully deductible. Interest on guaranteed loans can be considered as related party interest.



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 companies that form part of a group interest expenses on external debt will also be subject to limited deductions (25% of EBITDA). The Norwegian part of such a group is proposed to have a combined threshold of NOK 10 million for the limitations to apply. However, two alternative escape clauses for the rules are now also proposed under which the company or group can escape the limitations completely provided the following requirements are met;

- 1) The relevant company on a stand-alone basis has a debt to equity ratio similar to or stronger than the consolidated debt to equity ratio in the group which the company is a part of (defined by financial accounting rules).
- 2) If the Norwegian part of the group has a consolidated debt to equity ratio which is similar to or stronger than the consolidated debt to equity ratio in the wider group (defined by financial accounting rules).

The rules are proposed to come into force from the income year 2018.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are generally no tax incentives for equity financing in Norway.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Losses in the target company are generally available after an acquisition. There are, however, special anti-avoidance rules which apply if the acquisition is mainly tax motivated. If the acquisition is mainly tax motivated, the losses will be eliminated.

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 Norwegian tax authorities have in later years been focusing on transfer pricing, the allocation of costs between group companies and reorganisations of group companies (e.g. if the consequence is a step up on the value of the tangible and intangible assets, or a debt push down). Thus, we recommend that these matters are included in the request list and that the target company must give an account for such transactions.

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

There are no indirect taxes, stamp duties or similar assessed on the transfer of shares.

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

Yes. Typically most acquisition costs for share deals will not be deductible. The nature of the costs must be assessed. Costs related to the financing are normally deductible. Acquisition costs related to asset deals must 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 gain on shares for corporate shareholders is tax free 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;



- ❖ Costs related to incorporating BidCo
- ❖ Costs related to financing the acquisition
- ❖ Costs related to the structuring of the corporate structure of the acquisition
- ❖ Costs related to 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 not usually possible to recover such VAT. However, under certain conditions, acquisition costs can be deducted provided that the buyer is registered in the Norwegian VAT register and performs business which is subject to VAT.

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 BY FOREIGN COMPANIES?

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 20 below) and treaty protection (“beneficial owner”).

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

Yes. There are tax consolidation rules and rules which provide for tax neutral reorganisation. However, there are anti-avoidance rules that could be applicable if the sole purpose of the transaction is tax motivated. In addition, there are some restrictions with regards to mergers in the Norwegian company law, e.g. the acquisition debt cannot be placed in the acquired company. Also, a cross boarder merger/demerger can be considered as a taxable event (exit tax) if business is taken out of Norwegian tax jurisdiction.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 not, however, any stamp duty triggered upon the transfer of shares, even if the main assets of the company are real estate. Thus, it is in Norway usual to organise real estate in (single purpose) companies and to transfer the shares in the company rather than the asset, implying that the seller avoids both capital gains taxation (due to the exemption method) and stamp duty.

VAT implications must also be considered. Such transaction may have severe impacts on the deductibility of VAT on accrued costs. In addition, Norway has adjustment rules for VAT on capital goods which must be considered.

The seller must normally give the purchaser a tax rebate if the 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 (9-10% for buildings with 2% depreciation rate) 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.

As the interest deduction limitation rule caps the deduction of interest at 25% of an EBITDA calculated for tax purposes this should be a particular issue to consider.

In addition, several municipalities have introduced property tax on the value of the real estate. In the municipality of Oslo, the property tax is 0.2%. Thus, the element of property tax must 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 a tax consolidation between group companies which are domiciled in Norway provided that top company holds more than 90% in each of the subsidiaries. A company within the group, which is taxed for profit, can transfer its taxable profits to another group company to cover tax losses.

For VAT purposes it is possible to register a group together provided that the top company holds at least 80% in its subsidiaries.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 24%. It is possible to obtain tax deferral on capital gains from sale of business assets, normally by annually entering 20 pct. of the capital gain as income (applying the declining balance method).

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

There are no fiscal advantages if the proceeds from the sale of shares are reinvested. Individual tax payers must enter the capital gain as income for the year in which the capital gain is realised. As note above, corporate tax payer are generally be exempt from capital gains taxation on shares.

However, in asset deals, gains on assets which may be depreciated (real estate, IPR, goodwill, machines etc.) may be deferred under special rules. Most gains are taken as income with 20% on a declining balance basis.

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

There is no substance requirement for domestic holding companies. The holding company must, however, have effective management in Norway in order to meet the tax residency test.

Foreign holding companies are subject to Norwegian withholding tax on dividends distributed from Norwegian subsidiaries, however, there is a domestic exemption for distribution to shareholders domiciled within the EEA. There is no minimum shareholding required, however, the shareholding company must meet certain substance requirements. The withholding tax exemption will only apply if the company is genuinely established and performs real economic activity in an EEA state. The fulfillment of this criterion is based on the particular facts and circumstances where a key factor is whether the foreign entity is established in a similar way as an equivalent to a Norwegian company.

21. 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. The VAT adjustment period for real estate investments is 10 years. In mergers and spin-offs it is important that the VAT adjustment obligations are transferred to the acquiring company.



MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 is deemed earned income for the tax payer. Further, a general scheme applies under which the employer may offer up to 20 pct. discount on shares, provided that it is offered as a general scheme to the employees and the total (annual) benefit for each employee does not exceed NOK 3 000 (EUR 320).

It is expected that the Ministry of Finance will propose more favorable incentives legislation in the near future.

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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?

GAAR regulations

The most important changes with respect to M&A area between 2015-2017 concern in particular:

- ❖ Introduction of the new thin capitalisation regime – as of 1 January 2015 interest on loans paid to related parties (i.e. having at least 25% direct or indirect shareholding in the borrower or in the borrower and lender) are not tax deductible in the value of indebtedness exceeding the value of equity of the borrower
- ❖ Introduction of the anti-hybrid provisions with respect to dividends – as of 1 January 2015, dividends obtained by a Polish company from its EU based subsidiary does not benefit from the Parent-Subsidiary exemption if they were in principal in any form deducted from the income or tax by the company making the distribution
- ❖ Introduction of the anti-abuse regulations – as of 15 July 2016 a general anti-abuse rule (GAAR) was introduced into Polish tax law allowing in general to impose tax on operations that are aimed at achieving tax benefits in an artificial way. Additionally, specific anti abuse rules were introduced with respect to neutrality of mergers, spin-offs, exchange of shares transactions as well as dividend distributions between EU entities, when such operations are conducted without justified business reasons
- ❖ Taxation of the Close End Funds – as of January 2017, the scope of exemption from CIT for Closed End Investment Funds (so called FIZ) was limited. In particular income derived by FIZ from a Polish and foreign partnership is currently subject to 19% tax. Structures involving FIZ and Polish and foreign partnerships were widely used on the real estate market. The exemption of FIZ with respect to income derived from dividends, capital gains and interest (with certain exceptions) was maintained
- ❖ Introduction of the participation exemption regime for certain R&D companies – capital gains on the disposal of the minimum 10% of limited shares acquired in 2016 or 2017 and held for a minimum of two years in a company conducting R&D activities (further conditions apply) may be 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 clauses, real estate clauses 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 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. The Polish Ministry of Finance has declared willingness to sign the convention - the signing ceremony is planned to take place mid-2017.

Poland has also transposed the amendments provided by the EU Parent-Subsidiary Directive into its domestic legislation. This refers in particular to the anti-hybrid rule with respect to dividends obtained by Polish company if it was deducted for tax purposes by its EU subsidiary as well as anti-abuse rule with respect to dividend distributions.



As far as Anti-Tax Avoidance Directives are concerned, Poland also has already introduced to its tax system some of the measures intended by the ATA Directive (i.e. GAAR and CFC rules). As the Directive has not yet come into force, it shall not have an impact on the M&A transactions itself (the ATA Directive shall be implemented by Member states until the end of 2019 as the Directive coming into effect in 2020 at latest). There are no signals yet of how the ATA Directive will influence already implemented rules (as CFC, GAAR, thin capitalisation). Currently binding GAAR and CFC rules can be regarded as even more restrictive than provided in ATA Directive, while it seems that in many situations currently binding thin cap restrictions are less restrictive than those foreseen by the ATA Directive.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 costs 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 on the current approach of 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 realised on the transactions is subject to a standard 19% CIT rate. In both cases, income realised on disposal may be off-set with operating losses of the seller (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 FIZ.

B. Asset deal

From the buyer's perspective the general result of 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 organised 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.

Transactions 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 utilised via deduction from output VAT or direct refund.

Certain transactions may fall outside the scope of VAT (enterprises or organised 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.

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 AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Goodwill is depreciable only if it has arisen as a result of 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 commercialisation and privatisation. 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Deductibility of interest on debt used for financing the purchase of assets or shares of a target company is subject to general rules.

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

Some general restrictions on the deductibility of interest on loans can be however applicable and concern:

- ❖ Thin capitalisation restrictions: 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.

- ❖ 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.

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

A typical strategy to push-down the debt is a post-acquisition merger: The Polish SPV draws debt for the acquisition of the target, buys the target and subsequently merges with it. Another strategy could be the acquisition of assets of a target company financed by debt (e.g. a loan granted by an affiliated company or a third party bank) or liquidation of a target company.

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, deductibility of interest in the case of a post-acquisition merger is usually confirmed in individual tax ruling.

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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Generally, in the case of the acquisition of assets of the target company, the NOL and un-utilised losses of the target company remain with the seller. In the case of the acquisition of shares of the target company, 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. 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%. There are no specific anti-abuse provisions limiting this possibility.

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 target 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 will 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. 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.

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

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 (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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 apply 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

Generally Polish domestic law does not contain specific regulations for real estate entities. It should be kept in mind however that certain 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).

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.

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.



SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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). Any profits realised on such transactions are generally subject to 19% CIT. 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).

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. 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.

21. 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 nominal value of shares 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 %. 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.



Additionally, as part of the incentives initiatives, employees and management staff can be granted rights to participate in stock and option plans as part of which they can then receive in the future conditional rights to acquire shares in companies or other rights to companies' profits. In the hands of the beneficiary, income from such rights is likely to be subject to 19% personal income tax, opposite to the 18%-32% progressive rate for i.e. employment remuneration. However, as there are no clear provisions in Polish tax law in this regard, participation in those incentives schemes causes uncertainty as to the rules (especially tax point) of taxation for the beneficiaries.

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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.

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?

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.

In recently enacted tax treaties or protocols Portugal has negotiated the inclusion of Principal Purpose Test clauses (see, for example, the protocol with France or the tax treaties with Ivory Coast, Senegal or Saudi Arabia) rather than Limitations on Benefits clauses. This seems to indicate that Portugal would most likely opt for a Principal Purpose Test clause for the implementation of BEPS Action 6 in the context of the Multilateral Instrument.

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 realised 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;
- ❖ **Interest barrier rule:** since 2013, Portugal replaced its former current thin-capitalisation 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 amortisations). 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.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. 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 reorganisations whereby shareholding of the company is changed from direct to indirect ownership or from indirect to direct or
- (ii) reorganisations undertaken under the tax neutrality regime.



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 18 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” (sale as a going concern under Portuguese civil law) 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.

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 AMORTISATION OF GOODWILL 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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) EUR 1 million; or (ii) 30% of adjusted EBITDA. Interest in excess or unused interest (up to the EBITDA threshold) of the limit may be carried forward for 5 years. The concept of "net financing expenses" does not encompass financial expenses which were capitalised as acquisition cost of a certain asset (as these will be amortised 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.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 EUR 2 million. The notional interest deduction only applies to share capital contributions subscribed in cash or through the conversion of shareholder loans (granted in cash) into share capital. 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 reorganisations whereby shareholding of the company is changed from direct to indirect ownership or from indirect to direct;
- ❖ reorganisations 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 depending on the nature of the tax and if the target entity had tax losses or not 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 amortised / 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.

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

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 an exchange of information mechanism; and (iii) the company receiving the dividends (if a 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 18 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.

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

Upon completion of an acquisition, groups may reorganise 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 VAT taxable 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 state surtaxes up to 7.5% and a municipal surcharge of up to 1.5% of the taxable profits). Under the participation exemption 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) The 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.



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

The reinvestment regime provided by the Portuguese Code does not apply to the sale of shares. 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. This rule does not apply to investment properties (i.e. real estate).

20. 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.

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

As outlined above, generally the restructuring should be analysed 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. The exemption (or refund if requested after the transaction) is granted only upon specific request to the Minister of Finance (and consent is generally lengthy).



MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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?

Starting January 2016 a new Fiscal Code entered into force in Romania.

Amongst the changes brought by the new Code, certain amendments relevant for mergers and acquisitions (M&A) were implemented in the field of corporate income tax (CIT) and value added tax (VAT). Specifically, stricter conditions apply starting 2016 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 changes some of the rules relevant for private equity investments, of which we mention the decrease of the dividend tax rate from 16% 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).

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 March 2017, the Romanian Government approved, via a draft law, Romania's joining the BEPS Implementation Forum, which will allow Romania's participation in the implementation of measures against tax base erosion and profit shifting, as well as their domestic implementation.

Per the Romanian Government, the experience with this Forum would add value in view of implementing the Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD).

The Romanian Fiscal Code already contains certain rules which are also specifically dealt with by BEPS or ATAD (e.g. limitations to the deductibility of interest, or general anti-abuse rules). For instance, the Fiscal Code provides that cross-border transactions that are qualified as artificial would not enjoy the benefits of double tax treaties. Artificial cross-border transactions are those transactions lacking economic content and which cannot be normally used within usual business practices, their essential purpose being the tax avoidance or obtaining tax benefits that would otherwise not be granted.

Similarly, domestic or EU cross-border M&A deals may not enjoy direct tax neutrality if they aim at or result in fraud and tax evasion detected according to the law.

It is expected that Romania will implement the four minimum BEPS standards (which include Action 6) and that it may also sign the Multilateral Instrument provided by Action 15.

Separately, 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 AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 notarise (authenticate by a notary public) the share purchase agreement. 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. Special rules apply in case the target has to shift to the taxation system applicable to micro-enterprises. The target should apply the tax on micro-enterprises income (3% tax on qualifying income, instead of 16% CIT) 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 below EUR 500,000.

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 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 2017, the standard VAT rate dropped from 20% to 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. Starting 2016, 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. The 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, 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 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 the 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 recognised 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 recognised 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.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

According to general 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 dividends income or exempt capital gains upon disposals of shares acquired (if the holding conditions are met).

In addition, the deductibility of interest expenses on loans obtained from entities other than banks, leasing entities or other credit institutions (as listed by the Romanian Fiscal Code) is limited for each loan to the following thresholds:

- ❖ For loans denominated in foreign currency, the interest rate limit is currently 4% p.a.
- ❖ For loans denominated in Romanian currency (i.e. RON) the interest rate limit is the reference interest rate communicated by the National Bank of Romania for the last month of each reporting quarter (e.g. 1.75% p.a. in March 2017).

A second limitation on the deductibility of interest expenses (which remain deductible after applying the above test) and foreign exchange losses related to qualifying loans is the thin capitalisation rule which applies in case of long-term loans. If the specific debt-to-equity ratio exceeds 3:1, or the equity records a negative value, interest expenses and net foreign exchange losses related to long-term qualifying loans are not deductible for CIT purposes in the fiscal year concerned, but may be carried forward to be deducted in future tax years, as soon as the debt-to-equity ratio is positive and below 3:1. The debt-to-equity ratio is calculated as the ratio between the average qualifying debt and the average equity for the year concerned.

In addition if the debt is received from a related party, transfer pricing provisions should also be observed and applied with priority over the interest rate deductibility limitation and thin capitalisation rules.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 consequently 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.

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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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.

As for an asset deal, the target's fiscal losses may be off-set only against its future profits and therefore cannot be available 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 scrutinised 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 that the services acquired have been actually rendered and that they were acquired and used for business purposes;
- ❖ 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 the taxable basis for CIT purposes;
- ❖ Services acquired by the target from individuals organised 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). A 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 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 BY FOREIGN COMPANIES?

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.

Controlled foreign companies' legislation is not yet implemented in Romania.

Income derived by the non-resident investor from Romania (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 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.

Therefore 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 resident in a treaty country 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 single PE which is assigned to handle the CIT liabilities.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains obtained (from the sale of shares and/or of assets) by Romanian resident companies 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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR FOREIGN HOLDING COMPANIES?

There is no specific substance requirement for 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 security 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 model of a specific form that 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 their worldwide income.

Further, lack of substance of the foreign investor may lead to non-application of exemptions / reduced rates under DTTs etc. as described in the answer to question 14 above.

21. 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). As from 2016, 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Income received by individuals in cash or in-kind 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 at grant date and exercise date. Romanian Fiscal Code defines the stock option plan as being a programme 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 programme should provide for a minimum 1 year period between the moment when the right is granted and the exercise date.

In the case of the disposal of shares obtained through a stock option plan, the capital gains due by the individuals are determined as the difference between the sales 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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RUSSIAN FEDERATION



RUSSIAN FEDERATION

INTERNATIONAL DEVELOPMENTS

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

Rules have been introduced for the taxation of the profits of controlled foreign companies (CFCs) and the income of foreign entities. A CFC is a foreign company which simultaneously satisfies the following criteria: the company is not a Russian resident and a controlling person of the company is an entity and/or an individual that is recognised as a Russian tax resident. A controlling person of a foreign company is: an individual or a legal entity holding more than 25% in the company; an individual (together with spouses and minors) or a legal entity holding more than 10% in the company, if all persons (if individuals, then together with their spouses and minor children) who are recognised as Russian tax residents hold a shareholding of more than 50% in the company.

If taxpayers that are recognised as Russian tax residents are found to have a controlled foreign company, such taxpayers must notify a tax authority of its membership in foreign companies (of having established unincorporated foreign structures) and of controlled foreign companies which they control.

A CFC's profit is equated to the profit of a person that controls such CFC and should be taken into account when the corporate profit tax base (for companies) or the income tax base (for individuals) is determined. A CFC's profits may be calculated based on the CFC's financial statements or by the rules for calculating corporate profit tax in the Russian Tax Code (the 'Code'). The Code provides for a definite exhaustive list of grounds for granting exemption to CFC's profits at the level of a controlling person.

If a foreign company is liquidated, provided the liquidation procedure is finished by 1 January 2018, a taxpayer will be entitled, when determining its tax base, not to record income such as the value of property received.

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 action plan 3 provides for more stringent rules for the taxation of profits of controlled foreign companies (CFCs). In this regard, rules have been introduced in Russia for the taxation of profits of controlled foreign companies (CFCs) and of the income of foreign entities. Similarly, to the objective with CFC under BEPS, the above rules are intended to eliminate the deferral of taxation of profits and restrictions on passive income being artificially allocated to foreign low tax jurisdictions. Moreover, the CFC rules in Russia are also intended to combat offshore tax planning and tax abuses.

❖ **Action 4** implies constraints on the opportunities for diluting profits by making interest payments and implementing other financial schemes. In the Russian Federation, a 'thin capitalisation' mechanism has already been implemented and is in effect. Starting from 1 January 2017, additional grounds have been introduced in the Russian Tax Code for recognising outstanding debt obligations as controlled debt. The Russian Tax Code defines the criteria of comparability under which debt to a Russian 'sister' company will not be considered controlled debt.

❖ **Action 6** proposes measures to prevent tax treaties for the avoidance of double taxation from being abused. Starting from 2010, the Russian Government Resolution has adopted a standard agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and property, which included article 29 "Restriction of benefits". Specifically, benefits and preferences, for which existing international treaties to which Russia is a contracting state provide, should not be applied if:



- 1) in the opinion of competent authorities, if such benefits are provided, this will result in the abuse of the treaty from the perspective of its goals;
- 2) after the treaty is signed, one of the contracting states establishes a preferential tax treatment with respect to the offshore income;
- 3) a shareholding of more than 50% in a foreign company is, directly or indirectly, owned by persons that are not residents of the state where the company carries out its operations (this provision, however, will not be applied if the owner carries out most of its business operations in the state where the foreign company is located, except for when it simply holds assets or carries out auxiliary operations).

The concept of a beneficial owner (a beneficial owner of income) has been undergoing brisk development in the Russian Federation. The concept of a 'beneficial owner of income' has been used in different wordings in early international double tax treaties which Russia concluded (e.g. in treaties with the US, Canada, France, Japan, etc.) Russian case law takes account of the Russian concepts of a beneficial owner of income, a business purpose doctrine and a bad faith taxpayer doctrine, which have been formulated by the supreme court in Resolution No. 53 of the Plenum of the Supreme Commercial Court. These doctrines enable tax authorities and courts to assess a taxpayer's business operations not only based on formal grounds, but primarily on the totality of circumstances in which such operations are carried out.

The Russian Federation undertakes measures to streamline information exchange between different states to combat bad faith tax planning, the dilution of a tax base and the channeling of capital to offshore jurisdictions. In 2016, the Russian Federal Tax Service signed a multilateral Agreement of competent authorities regarding the automatic exchange of financial information. Starting as early as 2018, the Russian Federation will receive information from foreign tax authorities regarding foreign accounts of Russian tax residents. It is expected that in 2018 the Russian Federation will join the system of automatic exchange of information (Declaration dated 6 May 2014, Paris).

- ❖ **Action 13** proposes recommendations as to how transfer pricing documentation should be changed so that it complied with standardisation and disclosure requirements to different countries. At the moment, the Russian Finance Ministry has prepared a draft federal law on amending the Tax Code in terms of the preparation and submission of inter-country financial statements. The draft federal law provides for a mechanism for the collection by Russian tax authorities of information required in order to be shared with competent authorities of foreign states within the scope of the implementation of the Multilateral Treaty. For example, the draft federal law obliges taxpayers which are members of an international group to notify a tax authority of their membership in the international group and submit its inter-country financial statements starting from 1 January 2017.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

- 1) Under Russian tax legislation, share deals are not subject to Russian VAT;
- 2) A zero profit tax rate (if certain requirements for shares are complied with) is applied to the tax base determined based on sales or other disposals (including redemption) of shares of Russian companies (membership interests in the issued capital of Russian companies) provided that as at the date of sale or other disposal (including redemption) of such shares (membership interests in the issued capital) a taxpayer has continuously held an ownership title or any other proprietary rights to such shares for more than five consecutive years);



- 3) From a legal perspective, in a share deal, there is no requirement to re-sign contracts with existing contractors of the target or to obtain new licences. Share deals are a convenient way to acquire an enterprise without affecting its business processes, contractual obligations or clientele.

Tax disadvantages:

- 1) Adverse tax consequences may result from a deal for real estate by way of a share deal without any substantial business purpose other than a tax saving. There is some case law recognising a share deal as a real estate deal (if the real estate constitutes a base asset). However, the court has ruled against the taxpayer in a similar case, considering that the transactions were made with the sole purpose of avoiding VAT. As a result the tax consequences have to be the same as if the taxpayer sells immovable property. Additional VAT may be charged to the seller. In turn the seller has the right to demand payment of such additional VAT from the company;
- 2) Transfer of the title to the shares does not increase the value of the base assets.

B. Asset deal

Tax advantages:

- 1) The value of the base assets of the acquiring party increases;
- 2) An asset deal does not result in the transfer of any tax risks and tax obligations of the acquired business to the acquiring party.
- 3) The expenses on the real estate acquisition form the initial cost of the property and may be deducted through depreciation (except for expenses on land);
- 4) The process of registering a property right can take a long time but it does not entail tax risks (the company has the right to charge depreciation. The company also has the right to apply for a deduction of VAT before the time when the property right is registered).

Tax disadvantages:

- 1) An asset deal is subject to Russian VAT at the rate of 18%. This amount will be however recoverable as input VAT if the Company has a VAT-invoice and uses the property in industrial activities. Therefore, it will not result in an additional tax expense;
- 2) When property is transferred as a contribution to the issued (joint-stock) capital of business entities and partnerships, the amounts of VAT deducted in relation to goods, work, or services, including fixed assets, must be recovered.
- 3) When a company is purchased as a set of assets and liabilities, such a transaction is complicated in terms of taxation. This transaction is possible only if a certificate of registration of the set of assets and liabilities as an enterprise has been obtained.
- 4) The tax base in the event of a sale of an enterprise as a whole set of assets and liabilities is determined separately for each type of asset of the enterprise. If the purchase price exceeds the value of the net assets, the buyer will be entitled to deduct this price surcharge not in one go but over five years, beginning from the month following the month of state registration of the buyer's title to the enterprise;
- 5) The Russian Tax Code does not stipulate a procedure for accounting for fixed assets purchased within the enterprise sold as a set of assets and liabilities, in view of the fact that the sale price is determined for the property as a whole.



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 tangible and intangible assets in the case of share deals is not allowed since the acquisition of shares does not increase the value of the underlying assets. In practical terms, the parties would usually arrange for an independent appraisal by an appraisal company. The appraisal, however, may be contested by tax authorities during a tax audit.

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

Goodwill is amortised in Russia over 20 years (but for no longer than the company's business operates) and only for accounting purposes. Amortisation for tax purposes is not stipulated by Russian legislation.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are no specific rules set by Russian tax legislation limiting the deduction of interest under borrowings in the cases of an acquisition of shares, and of assets. General rules have been established restricting a deduction under debt obligations (controlled debt).

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

Tax authorities have been actively fighting push-down strategies. Authorities may refuse to offset losses for transactions made between a loss-making enterprise and a profit-making enterprise where no business (economic) purpose of the transaction (except for saving on taxes) is determined. The refusal may be based not on statutory regulations but rather on the business purpose doctrine established by Resolution No. 53 of the Plenum of the Russian Supreme Commercial Court. Moreover, starting from 2017, restrictions are being introduced on decreasing the tax base of the current period by amounts of losses incurred in previous tax periods. For the period between 1 January 2017 and 31 December 2020 the base may be decreased by a maximum of 50%.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Russian tax legislation sets out a general rule for offsetting losses incurred in previous periods against the tax base of the current period. For the period between 2017 and 2020 the tax base cannot be decreased by more than 50%. A change in ownership of an enterprise (whether through a share or asset acquisition) does not have an impact on the possibility to offset losses. However, tax authorities can re-evaluate a transaction if they consider that it did not have any business purpose (if the only purpose of the transaction was tax saving by offsetting loss) and they may consequently refuse to recognise losses in the context.

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

One of the specific features of performing due diligence in Russia is the need to check whether the taxpayer's counterparties are acting in good faith. This includes, without limitation, checking whether counterparties fulfil their tax obligations; checking what reputation counterparties have (market awareness, etc.). If any transactions between the taxpayer and counterparties acting in bad faith are identified, the amount of unpaid tax may be



collected from the taxpayer. In addition, special attention should be paid to intra-group services. Court practice in Russia over the past several years has not been evolving in favour of taxpayers. Tax authorities dispute whether such services are economically justified.

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

A statutory fee is set out for the state registration of the issuing (additional issuing) of securities by a competent authority. No other indirect tax is prescribed for transfers of shares.

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

The expenses incurred by shareholders to acquire shares may not be taken into account to determine the tax obligations of the target company.

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

A sale of securities (including shares) is not subject to VAT. When property is transferred as a contribution to the issued (joint-stock) capital of business entities and partnerships, the amounts of VAT deducted in relation to goods, work, or services, including fixed assets, must be recovered. The amounts of the tax which must be recovered are not included in the value of property, intangible assets, and property rights; also, the tax deduction should be made by the receiving company. Moreover, when the core asset of the target company is immovable property, the transaction may be reclassified as a sale and purchase of property and be subject to VAT.

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

No.

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


N/A.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The Russian Tax Code prescribes that income received from sale of shares (membership interests) of companies, more than 50% of whose assets are directly or indirectly comprised of immovable property located in Russia and also of financial instruments, which are derivatives of such shares (membership interests), save for shares which are recognised as shares traded on an established securities market, is considered to be a foreign company's income from sources in Russia and is subject to taxation. No other specific regulatory features are established for the sale and purchase of shares where the core asset is immovable property. Nonetheless, it is likely that such a share sale and purchase transaction will be reclassified as a sale and purchase of property and be subject to VAT. This approach is supported by court practice.

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

Tax legislation in Russia prescribes the possibility for companies to unite as a consolidated group of taxpayers based on the corresponding agreement establishing such a group. The consolidated group of taxpayers calculates profit tax taking into account the financial performance of all taxpayers that are part of such group. This group may be



comprised only of Russian companies (with some exceptions) which comply with certain criteria including at least 90% mandatory participation in the equity of companies which are part of such group; the total amount of tax paid should be at least RUB 10 billion; the total amount of revenues should be at least RUB 100 billion; and the total cost of assets indicated in the accounting (financial) reports should be at least RUB 300 billion. Transactions between the members of the consolidated group of taxpayers do not fall under transfer pricing control.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

A zero profit tax rate is applied to the tax base determined based on sales or another disposal (including being redeemed) of shares of Russian companies (membership interests in the issued capital of Russian companies) provided that as at the date of sale or other disposal (including being redeemed) of such shares (membership interest authorised capital) a taxpayer has continuously held the ownership title or has had other proprietary right to such shares for more than five consecutive years.

The following income is not calculated for a company's tax base:

- 1)** Investment obtained from foreign investors (foreign companies or Russian-based subsidiaries with 100% foreign membership) to finance capital expenditure of a production nature provided that such income is used within one year after it is obtained.
- 2)** Property received by a Russian company on a free-of-charge basis:
 - a)** from another company, if more than 50 percent of the receiving party's issued (joint-stock) capital (fund) was contributed by the transferring party;
 - b)** from another company if more than 50 percent of the granting party's issued (joint-stock) capital (fund) was contributed by the receiving party and as at the date of transfer of property the receiving party has ownership of such contribution (share) in the issued (joint-stock) capital (fund). However, if the transferring company is a foreign company then such income will not be taken into account only if the state in which the granting company has its permanent location is not included in the list of states and territories granting a beneficial tax regime and/or not allowing for information to be disclosed and provided during financial transactions (offshore zones).

In this case the received property will not be classified as income for taxation purposes only if such property (save for monetary funds) is transferred to third parties within one year from when it was received.

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

No.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR FOREIGN HOLDING COMPANIES?

No statutory substance requirements have been established for holding companies but court practice always requires substance. Companies should have their offices at their registered address, own assets (property), employ staff, pay taxes in greater than minimal amounts; and they should have a business reputation. Tax authorities are entitled to go to court to collect tax arrears after an audit if such tax arrears have been pending for at least three months on affiliated companies (subsidiaries) or holding (controlling) companies if their accounts are credited with revenues from sale of goods (work, services) of such affiliated companies (subsidiaries) or holding (controlling) companies. Tax authorities are entitled to collect amounts if they establish that the revenues from sales of goods (work, services) were paid, the funds, or other property was transferred to a holding (controlling, participating) company or affiliated companies (subsidiaries) though a set of related transactions.



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

No.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

If the bonus (incentive) package is part of the employment contract then the payments made by the company may be deducted for tax purposes. If the bonus package is paid after dismissal, court practice allows for deductions for tax purposes only if the amount of the severance payment does not exceed five times monthly salary and if the economic justification has been confirmed.

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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?

In the 2016 Budget Review, tax avoidance schemes involving share buybacks were highlighted for review. Such schemes involve a company buying back shares from its current shareholders to avoid the tax consequences of share disposals. The seller receives payment in the form of a dividend that may be exempt from normal tax and dividends tax, instead of paying tax on the sale of shares. Following the announcement in 2016, no specific countermeasures were introduced in 2017. It was proposed in the 2017 Budget Review that specific countermeasures be introduced to curb the use of share buyback schemes.

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?

South Africa is a non-member country of the OECD, however, it has a working relationship with the OECD, and collaborates with it on a variety of policy issues. Action 6: in November 2016, South Africa adopted the Multilateral instrument capable of incorporating tax treaty-related base erosion and profit shifting measures into existing of bilateral treaties. The timeline for the commencement of the Convention is expected to proceed as follows:

- ❖ June 2017: a signing ceremony is planned, at which the more than 100 participating jurisdictions (including South Africa) will sign the Convention.
- ❖ Ratification of the Convention: the Convention itself will enter into force once five countries have ratified it.
- ❖ Effect on specific treaties: the Convention will enter into force for a specific double taxation agreement once all parties to that double taxation agreement have ratified the Convention and a specified period has lapsed in order to ensure clarity and legal certainty.

With regards to Transfer Pricing, the final regulations relating to Country-by-Country Regulations (“CbC”) have been published applying to years of assessments beginning on or after 1 January 2016. The SA Co who is a member of a group of companies and is not the ultimate parent entity must still notify the South African Revenue Service (“SARS”) of the identity and tax residence of the reporting entity.

The SARS is updating the Transfer Pricing Practice Note in line with OECD Transfer Pricing Guidelines to include new guidance on the arms-length principle and an agreed to ensure appropriate pricing on intangibles that are difficult to value.

There are two levels of record keeping which will be included in the Transfer Pricing Policy Document:

- ❖ Records in respect of structure and operations where the aggregate of affected transactions exceeds R100 million for a year; or
- ❖ Records in respect of transactions where one single affected transaction exceeds R5 million in value for a year.

Other action plans: South Africa already has legislation addressing these action points, however, SARS is reviewing the legislation in this regard to implement further refinements, such as the following:

- ❖ digital economy: foreign businesses supplying digital services in South Africa are already required to register as VAT vendors. The regulations are under review. South Africa is a member of the new Task Force for the Digital Economy, which is looking at direct taxes;



- ❖ hybrid mismatches: recommendations on transparent entities are being incorporated into the multilateral instrument. South African law has measures to limit double deductions, income exclusions where there is no corresponding deduction, and deductions with no inclusions. Further refinements may be considered in future;
- ❖ interest deductions: government is strengthening its efforts to curb excessive debt financing, which erodes the tax base, and will review the current limitation in light of OECD recommendations.

The Final Notice in terms of section 29 of the Tax Administration Act requires SA companies to keep a master file and a local file, irrespective of whether this company is an ultimate holding company or a subsidiary of the group.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A) Share deals

Tax advantages:

- ❖ Interest incurred on debt acquired to finance the acquisition of the shares may be deductible (subject to the interest limitation provisions).
- ❖ The supply of shares is an exempt supply for VAT purposes where the purchaser and seller are registered for VAT.
- ❖ The purchaser acquires the tax losses of the target company.

Tax disadvantages:

- ❖ 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.
- ❖ Securities Transfer Tax (STT) is payable upon the transfer of securities (which includes unlisted shares, shares listed on the JSE, as well as member's 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.

B) Asset deals

Tax advantages:

- ❖ The existing tax liabilities of the target company are not assumed by the purchaser.
- ❖ 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.
- ❖ 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).
- ❖ 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 acquire only part of the target company's business.

Tax disadvantages:

- ❖ VAT may be payable, thereby increasing the acquisition costs.



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 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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.

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 USUAL STRATEGIES TO PUSH-DOWN THE 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 3 above).

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Yes. The return of equity funding is generally exempt from tax in the hands of the lender. The Act does however, contain anti-avoidance provisions which re-characterises exempt divided income as taxable income in the hands of the lender were the equity instrument contains loan type features.



9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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?

No

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.

No transfer duty would be payable as transfer duty is only levied upon the transfer of immovable 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 such 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 BY FOREIGN COMPANIES?

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 33% (save for where the entity constitutes a permanent establishment, in which case 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.

Section 25BB of the Act stipulates that REITs are not entitled to claim certain capital allowances. This is because REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against rental income as the shareholders bear the tax liability. The REIT is precluded from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. This anomaly means the rules on reorganisation do not apply to transactions involving REITs. It was proposed in the 2017 tax amendments.

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

We do have tax deferrals under the corporate group reliefs that are available to the deferral of tax.

There are a number of exemptions under section 10 of the Act.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

CGT is payable by residents upon 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 (“South African property rich company”). An interest would include equity shares in a company where more than 20% is held (together with connected persons) in the company being disposed of, or a right of ownership, or a vested interest.; and
- ❖ any asset effectively connected with a permanent establishment of the non-resident in South Africa.

Therefore, where a non-resident acquires an interest in a South African property-rich company, whether South African or foreign, such non-resident will be liable for CGT upon the disposal of such equity shares, subject to treaty relief.

Only a portion of capital gains are taxable, and at the tax rate applicable to the particular taxpayer – for example:

- ❖ 40% inclusion in the case of a natural person;
- ❖ 80% special trust; and
- ❖ 80% in the case of a company.

A foreign company will thus suffer an effective tax rate of 22.4% on capital gains (80% x 28% corporate tax rate).

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 and 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.

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

No

20. 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. It is thus important that, where the holding/finance company wants to apply South Africa treaties and that the company's place of effective management remains in South Africa. Place of effective management is not defined in the Act, and is open to interpretation, but the current SARS view appear to be that a company's place of effective management is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made. This approach is consistent with the OECD's commentary on the term “place of effective management”.



Foreign holding companies' tax treatment in SA

Where foreign holding companies earn SA source income which is not taxed by means of a withholding tax, the SA tax exposure in respect of this will be determined in the same way as for SA resident companies and at the same tax rate (28%). Income taxed by means of withholding taxes (interest, dividends, royalties) will be subject to treaty relief, where applicable.

Beneficial ownership in context of withholding taxes

Where interest or royalties are paid to or for the benefit of a foreign company, or dividends are paid to a foreign company which is the beneficial owner of the dividend, withholding tax will arise, but may be reduced by an applicable double tax agreement. SA tax law does not contain substance requirements that need to be fulfilled before the withholding tax may be reduced. SA tax law does not contain substance requirements for the purposes of applying treaties.

Furthermore, SA tax law does not define the concept "beneficial ownership", except in relation to dividends (i.e. the person entitled to the benefit of the dividend attaching to a share). When interpreting and applying treaties, SARS will thus likely use the internationally accepted meaning of the concept of beneficial ownership.

Note that in certain treaties which SA has concluded, relief from withholding tax may potentially not be obtained in terms of the treaty where the recipient of the payment is not the beneficial owner of the payment, or alternatively where the recipient and the beneficial owner of the payment differ and they are not residents of the same contracting state. This should be evaluated on a case-by-case basis by making reference to the text of the treaty in question. Note that this is not a domestic law issue.

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

South Africa does contain special tax incentives for merger/spin-offs under the corporate roll over relief provisions contained under section 44 of the Act.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

In order to prevent employees (especially top management) from obtaining tax advantaged fringe benefits, the receipt of all equity instruments is treated on par with share appreciation rights. Any gains realised by an employee upon the vesting of equity instrument, which gain is the difference between the market value of the equity instrument at vesting and consideration paid by the employee to acquire the equity instrument, is included in that employee's taxable income in terms of section 8C of the Act.

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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 27 November 2014 and entered into force on 1 January 2015, has substantially modified the CIT regime previously in force. Likewise, certain tax measures modifying the CIT Act were approved in December, 2016.

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 investments 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 amortisation 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; financial expenses are fully deductible (subject only to the thin capitalisation rules); 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 DIRECTIVES?

Spain has partially adapted the CIT regulations to some of the measures proposed under some of the OECD BEPS action plans (as specifically remarked in the preamble to the new CIT Act) 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%.
- ❖ 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 above anti-abuse rules have not been included in the Basque CIT regulations, except for 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 of the Ad Hoc Group participating in the process of adoption of the Multilateral Instrument. Thus, the Spanish DTT network will be modified after the entry into force of the Multilateral Instrument. The scope of these modifications is still uncertain.

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. The Spanish government will have to review whether the domestic anti-abuse clause is in line with the EU Parent-Subsidiary, but, in principle, its current wording is very similar to that of the general anti-abuse clause foreseen in the EU Parent-Subsidiary Directive.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 Basque CIT legislation NOLs can be carried forward for 15 years (for NOLs generated before 2014, this 15 year period starts on 1 January 2014), but they can offset 100% of the taxable income of any year

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 amortisation 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 amortisation 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 amortisable 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 derive 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, 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 analyse 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 derived 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%). 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 7% and 11% (depending on the Spanish region that would be entitled to tax the transfer).

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 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 AMORTISATION OF GOODWILL IN YOUR COUNTRY?

The CIT regulations state that goodwill acquired following an asset deal can be amortised for tax purposes over a period of 20 years (at a maximum 5% 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 amortised 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

From 2012 onwards, thin capitalisation 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% 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 EUR 1 million 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 above limitations to the deduction of interest do not apply. Instead a 3-to-1 thin capitalisation rule applies to net debt with non-related entities. A different ratio may be applied if the company's debt leverage is proved to be set at arm's length. No limitations apply if the net debt from related entities does not exceed EUR 10 million at any time in the tax year. Transfer pricing rules should also be considered.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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 have to be carefully analysed 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% 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% 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 do not apply.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 (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 7% to 11%) 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% 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 are 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 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.

Finally, Basque tax regulations allow for 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. 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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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. 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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% 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 analysed 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 28% 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 7% to 11%) 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.
- ❖ In order 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Share deals

Capital gains obtained by Spanish residents from sales of shares are generally subject to a 25% CIT rate (28% 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% of the target's share capital, or if the minimum 5% stake is not held, the acquisition cost must be at least EUR 20M 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% 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, 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.

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% rate. Any potential capital gain can be offset against NOLs and other negative income, considering the limitations already described. Additionally, the capitalisation reserve can be applied (see section 19 below).

Under Basque regulations a full exemption of the gain is available subject to reinvestment of the sale proceeds. The general CIT rate is 28%.



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% 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% rate or 28% 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.

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

The CIT Law includes the so-called “capitalisation reserve” as an incentive for the reinvestment and capitalisation 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. 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.

20. 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 organisation 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).

21. 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 reorganise 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 realised 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 analysed 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 52%, 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?

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 expense or similar in its home jurisdiction (implementation of amendments of EU Parent-Subsidiary Directive).

Furthermore, on 30 March 2017, a government committee proposed amendments in the tax treatment of indirect sale of real estate, i.e. through the sale of the shares in a real estate owning company. Under current tax laws, such a sale does not trigger any income tax, provided that the conditions for participation exemption are met. Neither does such a sale trigger stamp duty, which is normally levied on the direct transfer of real estate at 4.25 per cent. In short, the committee proposed changes aiming to tax the indirect sale of real estate in the same way as a direct transfer. According to the proposal, the sale of a real estate company would trigger capital gains taxation in the company holding the real estate (deemed sale of the real estate at fair market value). In addition to the taxation of a capital gain, the real estate company is obliged to report a fictive income at 7.09 per cent of the fair market value of the real estate (corresponding to the after tax cost of stamp duty upon direct property transfers).

A proposal regarding amendments in deduction of interest expenses is expected during 2017. Whilst the proposal has not been made public, it is expected to include limitations based on EBITDA.

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 March 31, 2017. First year covered by the CBC is any financial year starting after 31 December, 2015. The first CBC report should be submitted by 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) about which entity that 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 are possible to apply 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 principle 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 principle 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 is part of the working group that is developing the multilateral instrument. Regardless of whether Sweden signs a joint agreement or renegotiates its different tax treaties, it is required that the agreement is approved by legislation in order for the changes to apply in Sweden.



❖ 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 in someone else's place 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.

Finally, as concerns inbound dividends, the amendment to the EU Parent-Subsidiary Directive has been implemented in Sweden through the introduction of a new provision in the Income Tax Act (see above). Note that the provision is extended also to non EU shareholdings.

Anti-Tax Avoidance Directive (ATAD)

The Swedish government is currently drafting a proposal for new rules on the limitation of interest deduction (see above). As of now, no legislation draft has yet been published. When presented, the legislative proposal must be in line with the interest limitation rule in ATAD.

Other than interest limitation rules, we are not aware of any other discussions on changes to domestic law following ATAD. This could partly be since Sweden already has extensive rules related to the other issues covered by ATAD, e.g. CFC-taxation, exit taxation and general anti-abuse rules.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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.

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 non-taxable event. The participation exemption regime may also be applicable for companies established within 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. Input VAT on costs related to share sales is, according to the opinion of the STA, not recoverable in Sweden. A recent court case from the Swedish Supreme Administrative Court (SAC) may however expand the field of VAT recovery on transaction costs incurred by the seller in share deals.

There are no other transfer taxes (however see above on proposed rules of indirect transfer of real estates).



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 losses carry forward, 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 between 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 are transferred (or an independent part of a business) the transfer of 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 highest 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 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 thought of 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 with 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 the 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 EEA or a treaty jurisdiction

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE 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?

According to newly introduced rules in Sweden, individuals are allowed a 50 percent 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 MSEK 1.3 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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 ("losses carry forward"). 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 losses carry forward could be transferred to a third party, whereby the loss could still be utilised by the company having the loss and also within the acquiring third party group. However, a change of ownership to a company with losses carry forward will trigger two limitations in relation to the losses, namely

- 1)** the amount of losses carry forward that will survive ("the amount limitation"), and
- 2)** the right to deduct losses carry forward against group contributions from companies within the acquiring group ("group contribution limitation").



It should be noted that the limitations only apply to tax losses carry forward. 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 losses carry forward. The same applies if a company with losses carry forward acquires the decisive influence over another company.

The maximum losses carry forward 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 contribution received by the company with losses). In other words, losses carry forward 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 carry forward 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 decided 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 by 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 has to 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 Q 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 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 emphasised 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.

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

❖ 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 at hand 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 at hand 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 inter alia following requirements 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 could be reduced partly or in full under tax treaties.



❖ Limitations in deduction of interest expenses

The limitations of deduction on interest expenses to affiliated companies should also be considered (see Q. 6).

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

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 for such business activity for 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 losses carry forward, whereby the existing losses may be forfeited or ring-fenced.

It is possible to transfer assets to 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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 a 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 a 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 for deductions to be made 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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. it 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.

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

There are no such rules in Sweden.

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

There are generally no substance requirements for holding companies tax resident in Sweden.

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

For mergers see Q 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's 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 may alter 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 being treated as an overall expense in the hands of the seller. The final word has not been said in this matter but this court case will definitely expand the deductible field for input VAT when it comes to transaction costs incurred by the seller in a share sale transaction.

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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

The participant in a management incentive programme 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 the fair market value, is subject to tax on employment income on 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 other tax brackets on holding 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 is 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.

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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 scrutinise 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 DIRECTIVES?

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.

As per 1 January 2017, Switzerland introduced into domestic legislation the mandatory minimum standard for a spontaneous exchange of information on tax rulings. 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 begins a year later on 1 January 2018 and covers tax rulings that were issued after 1 January 2010 and which will still be applicable on 1 January 2018 or afterwards.

In November 2016, for the implementation of the exchange of the Country-by-Country Report, the Swiss Federal Council submitted 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 for approval to the Swiss Parliament. If Parliament approves the proposal and no referendum is held, the CbC MCAA and the Federal Act could enter into force at the end of 2017. In Switzerland, multinationals being in scope of the CbC MCAA would be obliged for the first time to file with the Swiss Federal Tax Administration a CbC report with respect to the fiscal year beginning on or after 1 January 2018 within 12 months after fiscal year end. It is expected that the first exchange of CbC reports between Switzerland and its partner states would 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 participated in the preparation and negotiation of the multilateral instrument according to BEPS Action 15. Once the multilateral instrument has been signed, the Swiss Federal Council will submit it for approval to the Parliament.



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:

- ❖ Transformations: The individual sells his/her shares to a company he/she controls
- ❖ Securities dealer: If the seller qualifies as a professional securities dealer – or if, according to the Swiss Supreme Court an individual seller regularly and systematically deals with securities – the capital gain is subject to Swiss income tax and social security contributions
- ❖ 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 AMORTISATION OF GOODWILL 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS 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 2017, 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 2017, the maximal interest rates for loans denominated in US dollars amounted to 2.5% 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 USUAL STRATEGIES TO PUSH-DOWN THE 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 Swiss Corporate Tax Reform III it is evaluated whether a notional interest deduction on surplus equity capital will be introduced as a compulsory or voluntary measure at federal level and/or cantonal / communal level.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

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. 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. 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 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 15 of the Agreement between the European Community and the Swiss Confederation (providing for measures equivalent to those laid down in the Directive 2003/48/EC on taxation of savings income in the form of interest payments) 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 REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 or 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.

19. 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.

20. 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 capitalisation 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.

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

A company reorganisation can qualify as a tax neutral reorganisation (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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

The principle that capital gains are being treated as tax-free is offering great planning opportunities for manager remuneration.

Such capital gains may be realised 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 tax-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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TURKEY



TURKEY

INTERNATIONAL DEVELOPMENTS

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

Recently, there are no tax developments in Turkey which are relevant for M&A deals.

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 OECD introduced the Base Erosion and Profit Shifting (BEPS) project with 15 Action Plans including Action 6: Preventing the granting of treaty benefits in inappropriate circumstances. The preparation process for the adaptation of the action plan to local legislation still continues in Turkey. There are draft changes which have not been published yet.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

If the shareholder is an individual:

- ❖ If the seller has held the shares of a joint stock company for more than two years, there is no taxation on the capital gain. Otherwise, the capital gain is subject to taxation as per the tariff in Turkey's Income Tax Code, i.e., from 15% to 35%. If the company being sold is a limited liability company that does not have share certificates, then the capital gain is subject to taxation as per the tariff in the Income Tax Code.
- ❖ Share sales to individuals are not subject to value-added tax.

If the shareholder is a Turkish resident company:

- ❖ If the Turkish resident company has held the shares of the company (a joint stock company or a limited liability company) for more than two years, then 75% of the capital gain is exempt from taxation and the remaining 25% is subject to corporate income tax of 20%. In other words, the effective tax rate is 5%.
 - Sale price: 200
 - Cost price: (100)
 - Capital gain: 100
 - Exempt income: 75
 - Taxable income: 25
 - Corporate income tax (20%): 5
- ❖ For a buyer to benefit from this exemption, the sale price should be collected until the end of the second year in which the sale transaction is realised. Additionally, the exempt amount cannot be distributed for five years.
- ❖ If the holding period is less than two years, there is 20% corporate income tax. If the shareholder company is not resident in Turkey:



- ❖ If the buyer is also not resident in Turkey, there is no taxation in Turkey. Taxation will be in the country where the shareholder of the company is resident.
- ❖ If there is a double tax treaty between Turkey and the country where the seller is resident, the treaty is applicable.
- ❖ If the shareholder is a company that has held the shares for more than two years, there is no VAT on the sale transaction.
- ❖ If there is a written agreement between the parties, there might be stamp tax payable on the agreement, depending on the nature of the agreement.

As explained above, depending on the details of the transaction, an asset deal can be subject to more tax than a share sale.

Merger, demerger and share exchange transactions where applicable are tax-free transactions under Turkish tax legislation, provided that the conditions stated in the legislation are fulfilled.

B. Asset deal

The capital gain on a sale of assets is subject to 20% corporate income tax. Capital gains are based on the difference between the net book value of the assets in the balance sheet and the sale price.

There is VAT of 18% on the sale price.

On the other hand, 75% of the gains from the sale of any real estate assets that have been held for at least two years may be exempt from corporate income tax, if:

- ❖ The sale price is collected before the end of the second calendar year following the year in which the sale occurred;
- ❖ That portion of the gain benefitting from the exemption is maintained in a special reserve account on the balance sheet for 5 years; and
- ❖ The selling company's business is not the trading or leasing of real estate.

In addition to this, the sale of any real estate assets that have been held for at least two years may be exempt from VAT.

Where there is a written agreement between the buyer and seller, there might be stamp tax of 0.948% on the amount mentioned in the agreement. However, the stamp tax is subject to a ceiling for stamp tax liability, which for the year 2017 is set at TL 1,865,947.

Land and building transfers will be subject to title deed charges at a rate of 1.5%. The basis for the deed is the sale price. Where the sale price is lower than the tax value determined by the municipality, the tax value is the base. Title deed charges should be paid on registration day at the title deed office. The charge is applicable for both buyer and seller, therefore the total rate is 3%.

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?

For statutory accounting and tax purposes, it is not possible to step up the value of the assets in the books, since the assets are booked on the purchase values and subject to depreciation on the accounts.

These assets are subject to valuation, which may affect the sale price of the shares.

Transfer pricing rules — i.e., the arm's length principle — apply in the case of a sale to related parties.

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

Depreciation rates are determined and announced by the Ministry of Finance, based on the useful life of the assets. The latest rules are applicable to fixed assets purchased after January 1, 2004.

For fixed assets other than passenger cars, depreciation is granted for the full year, regardless of the acquisition date of the asset. For passenger cars only, depreciation for the year of acquisition is calculated on pro-rata basis.

Two methods are available to taxpayers: straight-line method and declining-balance method. A taxpayer who initially chooses the declining-balance method for an asset may switch to the straight-line method. The taxpayer then spreads the written-down value over the remaining years, allowing for equal depreciation. However, those who begin with straight-line method may not switch to the double-declining method.

Intangible assets, like capitalised start-up costs and goodwill, are depreciated over five years. For start-up costs and goodwill, the declining-balance method is not allowed under the Turkish procedures code.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Effective from 1 January 2013, there are limitations regarding the deductibility of the expenses and cost items relating to foreign resources utilised in the companies such as interests, commissions, delay interests, foreign currency losses and other costs and expenses. According to this regulation, if the amount of foreign resources exceeds the equity capital of the company, financial expense restrictions will be applicable. The rate of the restriction for the concerned type of expenses shall be determined by the Council of Ministers, but this rate will not exceed 10%. Please note that as of 10 February 2016, the Council of Ministers' decision related to this issue is not published yet. However, the following issues should be taken into consideration:

❖ **Deductibility of interest on borrowing**

The portion of the interest expenses relating to the loans used to finance investments and the foreign exchange differences relating to the loans in foreign currency used to import fixed assets that have been incurred until the year-end date of capitalisation (acquisition) must be carried to cost, as provided under the Tax Procedures Code General Communiqué Series No. 163. The portion of the interest expenses relevant to the period subsequent to the capitalisation (acquisition) must either be recorded as expense directly or be carried to the cost of the concerned investment or fixed assets and become subject to depreciation, depending on the preference of the taxpayer.

Meanwhile, Tax Procedures Code General Communiqué Series No. 334 states that the portion of the foreign exchange differences that have occurred until the date of capitalisation must be associated with the cost. The favorable or negative foreign exchange differences that occur subsequent to the date of capitalisation must either be treated as foreign exchange gains or be deducted from the cost and become subjected to depreciation. Moreover, during the subsequent periods, the concerned taxpayer is obliged to adhere to the method selected during the previous period and to continue to apply the same method on the transactions.

❖ **Transfer pricing**

Transfer pricing through disguised profit distribution is defined in Article 13 of Corporation Tax Code No. 5520:

“Corporations shall be deemed to have distributed profits in a disguised manner through transfer pricing, if they are engaged in the purchase of goods and services from persons or entities that are in the position of related parties, at prices or amounts that are not in conformity with the arm's length prices or values.”

The same provision also states in a definite manner that all transactions that involve buying, selling, manufacturing, construction operations, lending and borrowing of money, and the payments of monthly salaries, bonuses, wages, or the like, must be considered as the purchase of goods and services, under whatever circumstances.



The concept of “related party” in the regulation refers to the real persons or entities to which the corporation, its own partners or the real persons or entities who have ongoing relations with the partners are affiliated, or which are under the control of the corporation, its partners or their related parties, from the standpoint of management, supervision or capital.

❖ Thin capitalisation rules

According to the rules on thin capitalisation, the minimum required debt-to-equity ratio is 3:1. Any portion of the related-party borrowing that exceeds 3:1 ratio (three times the equity) is treated as “disguised capital”. Interest payments and exchange losses corresponding to that portion of the borrowings from the related party are not deductible from the corporate profit. There is also a dividend withholding tax over the disallowable interest.

Interest and exchange losses corresponding to the related-party borrowings up to three times the equity are deductible without any limitation (and without any dividend withholding tax liability), provided that the interest rate is determined according to the arm’s length principle.

Borrowings from third parties are not taken into account while making the debt-to-equity comparison.

Borrowings from a related-party bank or a similar credit institution whose main field of activity is lending are taken into consideration at a rate of 50% (hence, the minimum required debt-to-equity ratio is 6:1 for borrowings from related credit institutions). However, if the activity of the credit institution is the procurement of funds among the group companies only, the whole amount of borrowings is taken into account when making the comparison (i.e., a 3:1 ratio is applied).

Loans from third parties under a cash guarantee are treated as a borrowing from a related party and are subject to thin capitalisation rules. Loans from third parties under a non-cash guarantee (like a letter of guarantee) of a related party, however, are treated as external loans and are not subject to thin capitalisation rules.

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

Debt push-down strategies are generally criticised by Turkish tax inspectors.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Through Article 8 of Law No: 6637 published in the Official Gazette dated 7 April 2015 and no. 29319, sub-paragraph (i) has been added to the 10th article of the Corporation Tax Code titled “Other Deductions”, and the equity capital companies were introduced the opportunity to deduct one half of the interest calculated over their capital increase in cash from their corporation tax base.

Through the concerned regulation, the general rate of deduction was determined as 50%, and the Council of Ministers was authorised to implement this rate differently based on the provisions stated in the concerned sub-paragraph.

Within this framework, the Council of Ministers has exercised the authorisation bestowed on itself, and has determined the rates of deduction to be applied on capital increases in cash. Through the promulgation of the Council of Ministers numbered 2015/7910 in the Official Gazette dated 30 June 2015 and no 29402, effective as of 1 July 2015, the rate of deduction to be applied on capital increases to be applied pursuant to Article 10/1-ı shall be applied at a rate of 50%.

- a) Of the public offering equity capital corporations who benefit from the deduction and who have shares that can be purchased and sold in the stock exchange at the level of Merkezi Kayıt Kuruluşu A.Ş. of whose rate of nominal value corresponding to the paid in or issued capital, shall be implemented by adding the following rates:

- Those that have a rate of 50% or less; plus 25 points
- Those that have a rate of over 50%; plus 50 points.

b) In the event that the capital increased in cash is used in the production and industry facilities with an incentive certificate and in the investments concerning machinery and equipment relating to such facilities, and/or in the investments concerning lands and lots allocated to the construction of these facilities, remaining limited to the fixed investment total stated in the investment incentive certificate; plus 25 points.

On the other hand, the 50% rate of deduction will be applied as follows:

- For the equity capital companies of whose 25% or more of their income consist of passive income such as interest gains, dividend income, rental income, license fees, income from the sale of securities other than commercial, agricultural or independent professional activities through capital, organisation and personnel recruitment: 0%
- For the equity capital companies of whose 50% or higher portion of assets consist of non-current securities, non-current partnerships and participation shares: 0%
- Limited to the portion of the increased capital in cash that has been placed in other companies in cash, or that has been utilised as loans: 0%
- Limited to the portion corresponding to the land and lot investments in the equity capital companies who invest in lands and lots; 0%
- In the event that a capital reduction is performed during the period between 09/03/2015 until 1/7/2015, being the date on which sub paragraph (i) of the first paragraph of Article 10 of Law no. 5520 is put into effect, limited to the amount of the reduced capital: 0%.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

As per the corporate income tax code, the previous five years' losses are available provided that the losses are shown on the previous years' corporate income tax declarations separately.

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 Turkey limitation period is 5 years. Accordingly all tax declarations related documents should be evaluated for 5 years period.

Additionally especially related party transactions as well as receivable/payables to shareholders and cash account with a high balance should be included in the scope of tax due diligence.

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

As per the stamp tax code, written agreements are subject to stamp tax of 0.948% (general rate) in principle. There is no need to make a written share purchase agreement for a sale of the shares of a joint stock company, but the parties may decide to have a written agreement. This agreement may be subject to stamp tax.

For the transfer of the participation shares of a limited liability company, since this transfer should be done by notaries, stamp tax is applied by notaries as 0.948% on the sale price.

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

In principle, there is no restriction on deductibility on acquisition costs related with financial expenses.

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

Yes, VAT (if applicable) can be recovered on acquisition costs.

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

Foreign investors can acquire 100% of the shares of Turkish companies in general.

There are no substance rules. On the other hand, there might be some legal issues or procedures to follow. For example;

- If the Turkish company is a limited liability company the share transfer agreement should be signed before notary public.
- The foreign investors should be notified to the Ministry of Economy.
- If 100% of the shares are transferred to foreign investors then there is a need to notify the Trade Registry.
- If there is a regulatory authority in the sector of the Turkish company and if there are restrictions concerning % of foreign investment there might be a need to get a pre-approval from the regulatory authority.

❖ Double tax treaty effect

If the target company is registered in a country with which Turkey has a double tax treaty, dividend withholding and capital gains taxes can be reduced.

❖ Controlled foreign corporation regime

Turkey applies controlled foreign corporation legislation. If the participation of the Turkish company is more than 50% in the target company, the income of the target company may also be taxed in Turkey, even if it is not distributed, provided that the following conditions are also fulfilled:

- More than 25% of the gross sales of the target company are passive income.
- The total tax burden of the income of the target company is less than 10%.
- The gross sale of the target company is more than TL 100,000.

Turkish holding regime tax exemption on capital gains is possible provided the following conditions are fulfilled:

- At least 75% of the assets other than the liquid assets of the company consist of participations in non-resident countries.
- There is at least 10% participation in each subsidiary.
- The participation period is more than two years.

Additionally, under the following conditions, the dividend income from non-resident companies is tax-exempt in Turkey:

- Participation is at least 10%.
- The holding period is at least two years.
- There is a total 15% tax on the dividend in the source country.
- The dividend income is transferred to Turkey until the related-year corporate income tax file is submitted.



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

After an acquisition, a group can reorganise in a tax-neutral manner, but this transaction may have tax results depending on the reorganisation. See “Share deals versus asset deals” above for what to take into consideration in a share deal.

A tax-free merger with another company that is not resident in Turkey is not possible. Also the EU Merger Directive is not applicable since Turkey is not a part of the EU.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

If a Turkish resident company is selling real estate that has been held for more than two years, then 75% of the capital gain is exempt from taxation and the remaining 25% is subject to corporate income tax of 20% — that is, the effective tax rate is 5%. To benefit from this exemption, the sale price should not be collected until the end of the second year the sale transaction is realised. Additionally, the exempt amount cannot be distributed for five years, and the seller company should not be in real estate trading activities.

If the holding period is less than two years or the company is in the business of trading real estate, there is 20% taxation on capital gains.

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

No, it is not applicable.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

There are no separate capital gains taxations in Turkey, as capital gains tax is part of the corporate income tax base. But there are some exemptions to capital gains tax — see the sections “Share deals versus asset deals” (from the buyer’s perspective) and “Special considerations for companies whose main asset is real estate” above.

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

Depending on the nature of the transaction, there can be fiscal advantages to reinvesting the proceeds from a sale.

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

There are not any local substance requirements, specifically for holding/finance companies.

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

Merger transactions realised within the conditions set forth in articles 19/1 and 20/1 of Corporate Income Tax Code are exempt from all kinds of taxes. The requirements set forth in the related articles to realise a tax-free merger are:

- ❖ Both companies (the transferee company and the transferred company) must be resident in Turkey.
- ❖ The transferee company must wholly take over the balance sheet of the transferred corporation as a whole (the assets and liabilities of the two companies shall be consolidated in their entirety in the transferee company).
- ❖ A merger tax return shall be submitted to the tax office within 30 days as of the merger date.
- ❖ The transferee company shall guarantee the payment of all tax liabilities of the transferred company.



Provided that all of the above requirements are met together, the merger (transfer of the assets and liabilities of the transferred company) will be exempt from following taxes.

Although the profits emerging from the merger operation are not subject to tax, the corporate profits of the dissolved corporation earned during the partial period to lapse from the beginning of the year until the date of the merger shall become subject to corporation tax in a normal manner, and shall be declared through a corporation tax return. If the above mentioned conditions are not met, besides the corporate profits earned until the date of the merger, the dissolved corporation shall be deemed as liquidated, and the profits earned through this liquidation shall also become subject to tax and shall be declared.

- ❖ **Corporate Income Tax:** The transfer of all the assets and liabilities from the transferred company to transferee company will be realised at the net book values of the assets and liabilities in the books of the transferred company. Hence, taxable gain or income will not be created as a result of this transfer. Hence, the transfer will be free from corporate income tax.
- ❖ **VAT:** According to article 17(4/c) of the Value Added Tax Code, merger transactions that are exempt from corporate income tax are also exempt from VAT. Hence the transfer of assets and liabilities will be free from VAT. The transferee company will be able to utilise the carried forward VATs of the transferred company, if any.
- ❖ **Stamp Duty:** All documents issued in relation to a merger transaction, including commercial agreement renewals with the distributors, suppliers, are exempt from stamp tax.
- ❖ **Real Estate Transfer Tax:** Real estate transfers in relation to a merger transaction which is exempt from corporate income tax are also exempt from real estate transfer taxes.

As per article 9 of the Corporate Income Tax Code the losses of the transferred company limited with the equity of the transferred company can be deducted from the tax base of the transferee company provided that the following conditions are fulfilled:

- The transferred company should file the corporate income tax declarations in time for the last five years;
- The business of the transferred company should continue in the transferee company at least for five years.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Management incentives are not applicable.

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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 proposed new legislation in the following areas:

- ❖ **Action 2:** Draft hybrid mismatch legislation has been published to take 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 is likely to take effect from 1 April 2017
- ❖ **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, which is likely to take 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

From 1 April 2017, the UK's corporation tax rate is 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 case 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 wishes to 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, following the OECD's release of the final text of the Multilateral Convention, has issued its draft approach to UK treaties for public consultation. The UK is expected to sign and ratify the multilateral instrument in 2017.



GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS 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 mainly aimed at ensuring that the profits are generated from the same activity. Losses from pre-acquisition periods in the target company cannot be offset against profits arising from the acquiring company. But post-acquisition, it should be possible to group relieve profits and losses between the target company and the acquiring company, provided the ownership conditions are met (broadly, being 75% ownership of the ordinary shares).

Stamp duty at 0.5% of the consideration 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 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 unknown liabilities behind.

There is also greater scope for immediate and future tax deductions. For example on stock, assets that qualify for capital allowances and goodwill, 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

Prior to April 2011, where a company left a group holding assets that have been transferred to it from other group companies, these assets were deemed to have been disposed of at market value and then re-acquired. This crystallised a capital gain de-grouping charge in the transferee company. This generally made a pre-sale hive down unattractive.

However since 1 April 2011 these rules have been relaxed. The de-grouping charge is calculated in the same way but now the gain is not crystallised in the transferee company, instead it is added to 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 shares disposal 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. 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 IN YOUR COUNTRY?

UK tax legislation enables a company that has purchased intangible fixed assets, including goodwill, to claim tax relief broadly to the extent that the acquisition cost is amortised in the company's accounts. A buyer can elect to have goodwill depreciated at a fixed rate of 4% per year regardless of the amount of depreciation taken through to the profit and loss account. This is particularly relevant for companies that account under International Accounting Standards (IAS). This tax-deductible goodwill arises on asset acquisitions.

Tax-deductible goodwill depreciation is not available on share deals.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Currently, UK tax authorities 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 Revenue, which would give certainty on the amount of interest that will be deductible. However, this will often include gearing covenants.

The UK tax authorities have proposed a new regime is to be implemented with effect from 1 April 2017 that restricts the tax deductions that are available for interest expense based on 30% of the UK group's EBITDA or group ratio based on actual net third party interest to EBITDA for the worldwide group. While the formal enactment of the new law has been postponed until after the General Election, this delay is not expected to lead to any deferment of the effective date of 1 April 2017. The rules implement BEPS Action 4 recommendations.

Worldwide debt cap legislation also applies to interest deductions available to UK companies. Under these rules the interest deduction is capped by reference to the net external finance costs of the worldwide group.

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 USUAL STRATEGIES TO PUSH-DOWN THE 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.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

A comprehensive set of anti-avoidance rules has been introduced to block transactions where the primary benefit to the buyer or to the seller was the existence of tax losses within the target company.

If a target company has incurred trading losses in its current or earlier accounting periods, a buyer will need to know whether the losses will be available to the target company in future accounting periods. The current UK anti-avoidance rules on trading losses apply 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 3 years on either side of the change in ownership change
- ❖ The change of ownership occurs between the sale of the company's activities becoming small or negligible and a considerable 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. However, new legislation proposed by the UK tax authority reforms the tax treatment of certain types of carried forward losses. The reform provides more flexibility in how losses arising on or after 1 April 2017 can be relieved and that the amount of profit that can be offset against losses carried forward will be restricted to 50% of profits in excess of £5m. Also when there is a change of ownership the following provisions apply:

- ❖ The time period over which a major change in the acquired company's activities can occur to restrict its losses is increased from three years to five years, either side of the change in ownership
- ❖ Any pre-acquisition carried forward losses in the acquired company cannot be group relieved for five years
- ❖ Where the acquired company makes profits and suffers a major change in the nature or conduct of its trade/business within five years of the acquisition, any pre-acquisition carry forward losses will not be able to be offset against those profits

While the formal enactment of the new law has been postponed until after the General Election, this delay is not expected to lead to any deferment of the effective date of 1 April 2017.

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 specialist 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 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.

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 has recently published (April 2017) revised guidance to confirm the position on the recoverability of VAT in light of the CJEU judgment in Larentia+Minerva in July 2015, they appear to generally accept that an active holding company should be entitled to recover VAT incurred when acquiring a new subsidiary, provided the holding company which receives advisors services undertakes economic activity that supports the taxable trading services of the business.

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

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 ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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 for 6 years if the company is sold outside the group. There are also stamp duty and stamp duty land tax relief clawback provisions that apply for 3 years

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

There are no particular issues to consider in the case of companies whose main assets are real estate. However, anti-avoidance provision may apply where a property trading, rather than investment, activity is undertaken in a corporate wrapper in order to achieve capital gains treatment on sale of the shares.

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

The UK does not have 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains realised by companies is subject to tax at the standard corporation tax rate.

Capital gains tax realised by individuals is generally taxed at 20% unless related to residential property which is at 28%. Reduced rates may be available if the shares disposed of were structured as an employee incentive scheme.

The only participation exemption for capital gains tax is in the substantial shareholding exemption. This exemption applies to the disposal of shareholding greater than 10% held for a continuous period of more than 12 months. The seller must be a trading company or a member of a trading group and the company sold must also be a trading company or the holding company of a trading group. There is a proposal that this test will be simplified by removing the requirement that the seller must be a trading company.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES 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.

20. 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. HMRC take 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.

21. 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

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 share 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 final disposal of the shares.

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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?

- ❖ **Contribution of appreciated property to a partnership:** The Internal Revenue Service (IRS) issued Notice 2015-54 in August 2015 to address perceived abuses relating to the transfer of appreciated property (including IP) to a partnership. Temporary and proposed regulations were issued in January, 2017 to implement the Notice. The regulations provide that gain is recognised when a U.S. person transfers appreciated property to a domestic or foreign partnership that has a foreign partner related to the transferor, and 80 percent or more of the partnership is owned by the US transferor and related persons, unless the partnership agreement includes specified terms ensuring that all built-in gain in the contributed property will be subject to US tax. The regulations generally apply to transfers on or after August 6, 2015.
- ❖ **Inversions:** In recent years, Treasury has issued regulations under Sections 7874 and 367(a), as well as Notice 2014-52 and Notice 2015-79, to curtail inversions of U.S. companies. When a U.S. corporation becomes a subsidiary of a foreign corporation or transfers its assets to a foreign corporation, and the foreign corporation is owned 80% or more (by vote or value) afterwards by former owners of the U.S. corporation, the foreign corporation will be taxed as a U.S. corporation. Where less than 80% but at least 60% (by vote or value) of the foreign corporation is owned by former owners of the U.S. entity, the U.S. corporation may not be able to offset any gain from establishing the inverted structure with any tax attributes (e.g. net operating losses or foreign tax credits) for 10 years after the inversion. The ownership calculation is subject to a variety of modifications that can have the effect of increasing the ownership percentage of the U.S. shareholders for purposes of these rules. New temporary regulations issued in 2016 affected the application of the ownership percentage test and in effect altered the stock included or excluded in computing the ownership percentage. The inversion rules can also be applied to U.S. partnerships. Care should be taken if there will be any rollover equity, as a rollover over 5% implicate an otherwise all cash transaction and make it subject to the US inversion rules.
- ❖ **Related Party Debt Classification:** Treasury issued new regulations in October 2016 to address the reclassification of related party debt to equity. The new regulations automatically recast related party debt as stock when the debt is issued by a U.S. corporation to a foreign or domestic corporation that is part of the same “expanded group” in a distribution, in exchange for stock, or in exchange for assets in a “reorganisation.” The regulations also institute new documentation requirements that will go into effect in 2018.
- ❖ **Tax Reform:** As of the date of this publication, business tax reform is still one a significant priority of the Administration and controlling political party in Congress. Under the two leading proposals, the corporate tax rate would be reduced from 35% to 15% or 20% and interest deductions would be reduced or eliminated. Other areas that could be impacted include inversions, IP planning, treatment of controlled foreign corporations, and documentation of related party debt.

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?

To the extent the BEPS recommendations overlap with the US FATCA regime, the US appears content to leave FATCA in place rather than to change its rules to conform more closely with BEPS recommendations.

The IRS has issued regulations to implement Action 13 (Country-by-Country Reporting) for US entities that are the ultimate parent entity of a multinational enterprise with annual revenue of USD 850 million or more, which would be effective for tax years beginning on or after June 30, 2016.



With respect to Action 6 the United States issued a revised U.S. Model Income Tax Treaty in February 2016 with a more restrictive limitation on benefits article. The United States appears to have limited interest in a multi-lateral instrument to amend its income tax treaties as nearly all U.S. income tax treaties now contain a limitation on benefits article.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

In a stock acquisition, the target corporation remains intact, and any pre-closing historical or contingent liabilities remain with the acquired company. Moreover, where a corporation is acquired from a consolidated group, it remains liable for the entire group's federal income tax during the period in which it was a member. Stock acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. Either way, the basis in the underlying assets of the target company carries over and is not stepped up — although where the target is a subsidiary within a consolidated group, complex rules may result in a step-down of the subsidiary's assets to avoid loss duplication. A section 338 election may be made to recognise built-in gains and losses in the assets of the corporation and adjust their basis to fair market value. However, in practice this is rarely used, unless the target corporation is a subsidiary in a consolidated group or a corporation that has elected to be a pass-through entity under subchapter S, where an election can be made without incurring double taxation of gains.

Tax advantages:

In the case of a stock acquisition without a section 338 election, any tax attributes, such as net operating losses or tax credits, continue with the acquired corporation (subject to the aforementioned loss duplication rules), but change in control limitations may be imposed on their use.

A stock acquisition often makes sense where an asset acquisition is not practical because it would subject the seller to two levels of income tax or because it would be too difficult to transfer the assets, contracts and licenses into the name of the acquirer.

The sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

It should also be noted that 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.

Tax disadvantages:

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. Asset deal

A significant reason for structuring a transaction as an asset acquisition is that 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.



Asset acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. In addition, it may be possible to treat the acquisition of certain entities as if an asset purchase occurred for income tax purposes even though it is the ownership interests that are legally acquired (i.e., through a Section 338 election, acquisition of a disregarded entity, or acquisition of 100% of a partnership).

Tax advantages:

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.

If the assets are acquired in a tax-free exchange, the acquirer generally takes over the target's historical basis in the assets. Other tax attributes are generally lost unless the acquisition is structured as a business combination that is classified as a "reorganisation." Here, the survivor succeeds to the target's historical attributes and liabilities, though the attributes may become restricted under various rules.

Asset purchases are usually most viable when the target assets are held in a pass-through entity such as a partnership or an S corporation (which is not subject to an entity-level income tax), or where the assets are held by a subsidiary of a consolidated group of corporations. In contrast, where the target assets are appreciated and held in a C corporation, an asset sale may not be practical because there are two levels of income tax: (1) corporate-level tax on the gain and (2) shareholder-level tax on any subsequent distribution to the shareholders. If, on the other hand, assets are depreciated, a C corporation with operating income may be motivated to sell assets in order to recognise loss and offset such operating income.

Tax disadvantages:

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.

Asset purchases may also create issues for many non-tax reasons. For instance, an asset purchase may not be feasible where the target business has significant assets, licenses or contracts that would be administratively burdensome or expensive to transfer or renegotiate.

It should also be noted that asset sales may give rise to both ordinary and capital gain (taxed at a reduced rate for individuals). In the case of a disposition by a foreign person, gain is ordinarily treated as effectively connected income subject to U.S. tax.

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 a corporate buyer purchases at least 80% of the stock (vote and value) of another corporation in one or a series of transactions within a 12-month period from an unrelated seller, it may be possible to make an election under Section 338 to treat the stock acquisition as an acquisition of assets for income tax purposes. Depending on the nature of the transaction, the election may be made unilaterally by the buyer or jointly by the buyer and seller. Situations where the target is an S corporation or a member of a consolidated group often provide the best opportunity for this type of planning.

A step-up may also be obtained under Section 336(e) where there is a "qualified stock disposition." A qualified stock disposition is a taxable disposition by a domestic corporation or the shareholders of an S corporation of at least 80% (by vote and value) of the stock of a domestic corporation during a 12-month period. A seller can make a Section 336(e) election, regardless of the legal form of the buyer(s). The Section 336(e) election may be



most appealing in circumstances in which the acquiring entity is an LLC or partnership. Care should be taken in assessing the requirements for a valid 336(e) election where there may be continued ownership by the sellers in the acquiring entity.

In the context of a foreign target, a Section 338(g) election should be considered, which also causes the transaction to be treated as an asset purchase for U.S. tax purposes. This election enables the target to step-up its basis in its assets and purge its pre-closing earnings and profits, thereby making it easier to push down debt and repatriate profits efficiently.

If a partnership interest is acquired, it may be possible for a buyer to step up its proportionate share of the partnership's underlying assets by causing the partnership to make an election under Section 754. Otherwise, the partnership's assets are not ordinarily stepped up, unless all the interests in the partnership are acquired by a single purchaser.

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

Intangible assets (including goodwill) acquired as part of a trade or business are amortised using the straight-line 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 TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

In general, a deduction is allowed for interest paid or accrued within a tax year on valid indebtedness of the taxpayer. However, numerous exceptions and provisions may limit or bar the deduction. Some of the major limitations are highlighted here:

Debt or equity considerations: Purported indebtedness may be reclassified as equity if the instrument characteristics create a sufficient resemblance to such. 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, and
- ❖ The thinness of the capital structure and the risk involved.

Additionally, as discussed in the Recent Development section, new regulations have been issued under Section 385 that can automatically recast related party debt as stock when the debt is issued by a U.S. corporation to a foreign or domestic corporation that is part of the same "expanded group" in a distribution, in exchange for stock, or in exchange for assets in a "reorganisation."

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.

Earnings stripping: Section 163(j) limits the deductibility of interest paid by a U.S. corporation if the debt is borrowed from or guaranteed by a related foreign person and the interest is exempt from U.S. tax or subject to a reduced rate of withholding tax. Section 163(j) applies if the U.S. corporation's debt-to-equity ratio exceeds 1.5 to 1. In general, the rule prohibits a corporation from deducting the interest paid to a related foreign person (or paid



on debt guaranteed by a related foreign person) to the extent its “net interest expense” exceeds 50% of the corporation’s “adjusted taxable income” (essentially EBITDA) as those terms are defined. Interest in excess of this 50% limit can be carried forward indefinitely, but must be subjected to the same limitation in future years.

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 USUAL STRATEGIES TO PUSH-DOWN THE 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 THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Generally, a net operating loss may be carried back to the two years preceding the loss and then forward to the subsequent 20 years to offset the taxable income in those years. 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 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. ARE 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 August 10, 1993, and for which amortisation was not allowed, to amortisable intangibles. The rules apply if the historic 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 August 10, 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 August 10, 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, click-through, 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 related tax, imposed on transaction costs incurred in the U.S.

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

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 “flow-through” 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.

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 network of treaty partners. 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 realised 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 so as not to create an inefficient “sandwich” structure.

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

A group may be able to reorganise and simplify tax neutrally after an acquisition through internal tax-free reorganisations, liquidations, mergers, etc. 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. consolidated return group for federal tax purposes.

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. Additionally, recent U.S. law 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. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The Foreign Investment in Real Property Tax Act (FIRPTA) taxes non-resident aliens and foreign corporations on dispositions of a U.S. Real Property Interest (USRPI), including dispositions of 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. 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.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 a maximum 35.0% 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.



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

Depending on the nature of the target business and the business objectives of the parties, it is possible for sellers to defer gain by reinvesting in the continuing enterprise. Caution should be exercised, however, to ensure these complex rules are satisfied.

20. 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. Companies not incorporated in the U.S. are generally not subject to U.S. income tax unless they have a sufficient presence (amounting to permanent establishment or “U.S. trade or business”) or receive certain passive type income subject to withholding.

Generally, choosing a holding company jurisdiction for the purpose of avoiding or reducing withholding tax can be challenging in the U.S. because of anti-conduit provisions under U.S. law and the limitations on benefits clauses in nearly all U.S. treaties. Generally, substance in the holding company jurisdiction is required. That said, various treaties provide reduced treaty rates.

Careful consideration should be given to the impact of the choice of jurisdiction of the holding company on other applications of withholding tax, including on interest and royalties paid by the U.S. company to related parties.

21. 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 also require a transfer by a corporation of all or part of its assets, immediately after the transfer the transferor is in control of the transferee and all the stock of the transferee is distributed. A post-spin merger of the transferor corporation will result in a taxable transaction. The rules for spin-offs are complex, and 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 will be treated as a taxable dividend.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

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 they would 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.

Compensation payment deferral, 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 payment of compensation for six month 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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