

# Tax on Inbound Investment

*Contributing editors*

**Peter Maher and Lew Steinberg**



2019

GETTING THE  
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*Contributing editors*  
**Peter Maher and Lew Steinberg**

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# Preface

## Tax on Inbound Investment 2019

Thirteenth edition

**Getting the Deal Through** is delighted to publish the thirteenth edition of *Tax on Inbound Investment*, which is available in print, as an e-book and online at [www.gettingthedealthrough.com](http://www.gettingthedealthrough.com).

**Getting the Deal Through** provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Ecuador and Korea.

**Getting the Deal Through** titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at [www.gettingthedealthrough.com](http://www.gettingthedealthrough.com).

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

**Getting the Deal Through** gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Peter Maher of A&L Goodbody and Lew Steinberg of Merrill Lynch, for their continued assistance with this volume.

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DEAL THROUGH 

London  
September 2018

# Austria

**Clemens Philipp Schindler and Martina Gatterer**  
Schindler Attorneys

## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The acquisition of shares (share deal) in exchange for cash or shares does not generally affect the target company itself (there are certain exceptions such as net loss carry-forwards, which may cease to exist, or recapture rules under the Austrian group taxation regime). The company continues to record its assets at book values. At the shareholder level, if shares are sold for cash, the selling shareholder realises a capital gain or loss equal to the difference between the sales price and the value of the shares in his or her books. A share-for-share exchange is generally also taxable, but may qualify for rollover treatment under the Austrian Reorganisation Tax Act.

When acquiring shares in an Austrian corporation, the acquirer has to capitalise the shares at their acquisition cost. In the case of a future disposal of the shares, a capital gain is subject to corporate income tax at a rate of 25 per cent or at the special income tax rate of 27.5 per cent if the seller is an individual. A capital gain is computed by deducting the book value of the shares at the time of disposal from the proceeds from sale less the costs of disposal.

In the course of the acquisition of business assets and liabilities (asset deal), the price has to be attributed to the transferred assets (ie, such transaction is treated as if the purchaser has bought the various assets separately) according to the going concern values of the individual assets of the business in order to determine the acquisition costs of the assets (ie, a step-up that allows for depreciation takes place). The remaining acquisition costs that are not allocable to the transferred assets have to be reported as goodwill. The acquiring company is not entitled to utilise any tax losses available to the selling company in respect of the transferred business.

If interests in a partnership are acquired, this is generally treated in the same way as described above for the asset deal, that is as a pro-rata purchase of the assets and liabilities of a partnership. Besides the purchase for a cash consideration, business assets and liabilities (if they constitute a business unit or division of a business unit) or partnership interests can also be contributed against the issuance of shares, and such transactions may also qualify for rollover treatment under the Austrian Reorganisation Tax Act.

Any capital gain resulting from the disposal of assets or a business is subject to corporate income tax at the standard rate of 25 per cent if the seller is a corporation or up to 55 per cent if the seller is an individual. In principle, there is no difference between the taxation of capital gains resulting from the disposal of assets and capital gains resulting from the disposal of a business (some allowances may apply under very narrow circumstances).

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In the course of an asset deal (or purchase of partnership interests) a step-up in basis in the business assets is achievable. Generally, the acquired assets have to be reported at their acquisition costs in the book of the acquiring company. Subsequently, the acquired assets may be depreciated over their expected useful lives. The differences between the price actually paid for a business and the acquisition costs of the individual assets has to be reported as goodwill. For Austrian tax purposes, the goodwill has to be depreciated over a period of 15 years on a straight-line basis.

There is no goodwill deduction in the case of the purchase of stock in a company acquired after 28 February 2014. For shares acquired before that date in an Austrian target that became a member in an Austrian tax group, a goodwill amortisation over a period of 15 years (capped at 50 per cent of the purchase price) was available. Goodwill amortisations from transactions before that date can be continued, to the extent that the goodwill amortisation influenced the purchase price of the shares. In this context it should also be noted that the statutory restriction of this goodwill amortisation to domestic targets violated EU law, according to case law.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

In a leveraged transaction, a purchaser will usually seek to implement a tax offset structure that is aimed at offsetting interest expense at the acquisition company (AcquiCo) level with profit generated at the target company level. In principle, there are two methods for achieving this.

The first method is to establish a tax group between the AcquiCo and the target company. In such tax group, the fiscal result of the AcquiCo and the target company is consolidated at AcquiCo level (ie, a negative fiscal result will be offset against a positive fiscal result). If the aggregated fiscal result of the AcquiCo and the target company is negative, the loss can be carried forward by the AcquiCo to future periods. The formation of such tax group requires a tax allocation agreement and an application to the tax office. The required minimum period of a tax group is fulfilled when three full fiscal years have expired. If the tax group is collapsed prior to the lapse of the three-year period, the group members are retroactively taxed on a stand-alone basis.

A second method, which is sometimes discussed but rarely ever implemented because of the significant implementation risk it involves, is an upstream merger of the target company into the AcquiCo. Based on past decisions of the Austrian Supreme Court, it is pretty clear that where the AcquiCo carries the acquisition debt for the purchase of the shares of the target company, a downstream merger of the AcquiCo into the target company will not be registered. In certain exceptional cases, an upstream merger of the target company into the AcquiCo may, however, be feasible. The result of such upstream merger would be that the shares in the target company pass to the AcquiCo, interest expense on

the acquisition debt can be offset against profit, and guarantees and security interests granted by the merged entity (holding the cash-generating assets) are not subject to the limitations under the Austrian capital maintenance rules and thus will be of greater commercial value to the financing banks. In particular, the last point is often of great interest to the financing banks, which is why this route is sometimes explored when a particular case supports the necessary arguments.

Regarding a future exit, it should be taken into account that double taxation treaties usually assign the right to tax capital gains to the state of residence of the shareholder. For that reason, a foreign seller will usually not be taxed on the capital gains in Austria. If, however, the seller is an Austrian tax resident, capital gains taxation applies (ie, no participation exemption is available for Austrian tax residents in relation to Austrian companies). Avoidance of withholding taxes on dividends is usually less of an issue, since pre-exit distributions are very rare. Still, to address that issue, EU entities are usually preferred over non-EU entities and, among the latter, entities from countries with which Austria has concluded a double taxation treaty. Accordingly, if a transaction is not leveraged, a foreign AcquiCo will usually be the preferred structure for a foreign purchaser. In case of a domestic purchaser, the interposition of a foreign AcquiCo would be under high scrutiny by the tax authorities, though.

#### 4 Company mergers and share exchanges

##### Are company mergers or share exchanges common forms of acquisition?

Company mergers or share exchanges as a form of acquisition are not as common between unrelated parties as in other jurisdictions such as the UK or the US. Accordingly, the transaction currency will usually be cash instead. However, when the parties aim to enjoy a rollover treatment, merger or share for share exchanges can be an attractive option.

Under Austrian tax law, mergers within the scope of the Austrian Reorganisation Tax Act are tax-neutral provided that the possibility to tax unrealised gains at the level of the legal successor (receiving company) is not restricted. In the case of a restriction, a merger into a receiving company in the sense of article 3 of the EU Merger Directive in its current version or if the receiving company is resident in an EU member state or an EEA country with which Austria has concluded a comprehensive exchange of information and enforcement agreement, the merger is taxable but the respective tax payment is deferred up to seven annual instalments upon request of the transferring company. If the receiving company does not meet the aforementioned requirements, the merger triggers immediate taxation. Towards EU or EEA entities this is a new and less favourable regime that applies to reorganisations resolved as of 1 January 2016, while reorganisations before that date could apply for a deferral of taxation until capital gains had actually been realised, and such taxation had been time-barred after 10 years. Accordingly, whereas under the past regime an exit taxation often had been avoided, this is no longer possible under the new regime. If capital gains were deferred under the old regime, the tax in such cases is also divided in seven instalments if so requested by the taxpayer.

#### 5 Tax benefits in issuing stock

##### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

Beside the possibility of the tax-neutral reorganisation under the Austrian Reorganisation Tax Act there are no further tax benefits to the acquirer in issuing stock as consideration rather than cash. However, in order to benefit from such tax-neutral reorganisation, it should be noted that the stock granted in consideration for the received assets does not necessarily have to be newly issued stock, but may also be existing stock (eg, transferred from other shareholders).

#### 6 Transaction taxes

##### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

There are no transfer taxes as such levied on the sale of shares in a corporation or on the sale of assets in Austria. Note that (minor) court fees for registration in the Commercial Register have to be paid.

Additionally, Austria levies stamp duties on a wide range of legal transactions, including:

- lease agreements (rate of 1 per cent);
- assignment agreements (rate of 0.8 per cent);
- agreements regarding easements (rate of 2 per cent);
- agreements regarding sureties (rate of 1 per cent); and
- pledge agreements regarding real estate (rate of 1 per cent).

Stamp duties are triggered whenever a written deed evidencing the transaction is signed in Austria or, in cases where the deed is signed outside of Austria, if certain criteria being considered as substitute documentation are fulfilled (note that it is not the transaction as such that triggers the stamp duty but rather the written deed). Stamp duties can thus be legally avoided if no written deed at all is set up by carefully carried out strategies. Debtors of the stamp duties are basically all parties of the agreements.

The sale of shares in a corporation is VAT exempt without the right to deduct value added input tax. The sale of assets is subject to VAT at a rate of 20 per cent. In this case, however, the exemptions set out in the Austrian Value Added Tax Act (eg, for real estate or shares) remain applicable. The sale of a business as a going concern is treated as the sale of the underlying individual assets (ie, there is no VAT-exemption for the sale of a business in its entirety). Therefore, the price of the business has to be divided according to the going concern values of the underlying assets. Tax rates and exemptions are applicable according to regular VAT law.

Real estate transfer tax (standard rate is 3.5 per cent) is levied on every acquisition of domestic real estate and in some cases also if shares in corporations or interests in partnerships that directly own Austrian real estate are transferred. In particular, the transfer of buildings and land, building rights and buildings on third party land falls within the scope of the Austrian real estate transfer tax; the transfer of machinery and plants is not subject to real estate transfer tax. Tax base of the real estate transfer tax is the amount of consideration for the transfer (fair market value), at least the value of the real estate.

According to the last tax reform (applicable to transactions effected after 31 December 2015), real estate transfer tax is triggered if 95 per cent (before the reform: 100 per cent) of the shares of a company that directly holds Austrian real estate are consolidated in the hands of one shareholder or a group of shareholders within the meaning of the Austrian group taxation regime. Furthermore, the tax reform also added a new taxable event: if within a period of five years 95 per cent or more of the partnership interests of a partnership that directly holds real estate are transferred, this triggers real estate transfer tax (under the scope of this new rule this can include several transactions with different purchasers). In each case the real estate transfer tax amounts to 0.5 per cent of the value of the real estate. The changed law now states that shares held by trustees are to be attributed to the trustor for the purpose of calculating the 95 per cent threshold. If Austrian real estate is transferred in the course of a reorganisation under the Reorganisation Tax Act, the real estate transfer tax will likewise be 0.5 per cent of the value of the real estate. The taxation based on the value of the real estate – in absence of a consideration that otherwise would be the tax base – was also introduced by the recent tax reform. Before that, taxation in such cases was based on an assessed value of real estate for tax purposes that usually was much lower than the fair market value.

In addition to real estate transfer tax, a registration duty for the land register at a rate of 1.1 per cent, also based on the purchase price or the value of the real estate, is levied if a new owner is registered (ie, not if shares are transferred, as the owner of the real estate does not change in such case).

#### 7 Net operating losses, other tax attributes and insolvency proceedings

##### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Insofar as losses are not deductible in one year they can be carried forward (there is no carry-backward available) to the next years for



corporate income tax purposes. Pursuant section 8, paragraph 4, No. 2 of the Austrian Corporate Income Tax Act a deduction of loss carry-forwards up to the amount of 75 per cent (with certain exceptions that allow a deduction of 100 per cent, like in the course of a liquidation or if a business unit is sold) of operating income is possible.

According to section 8, paragraph 4, No. 2, c of the Austrian Corporate Income Tax Act, loss carry-forwards expire if the 'economic identity' of the taxpayer has changed in a significant way. The law stipulates a three-part test to establish if such change has occurred. There has to be:

- a substantial change in the organisational structure;
- a substantial change in the economic structure; and
- a substantial change in the shareholder structure that has been made against consideration.

Generally, all three requirements have to be cumulatively met to consider that the 'economic identity' of the taxpayer has changed significantly. Despite the foregoing, some may be less pronounced, as the assessment depends on an overall view of relevant requirements, taking into account all facts and circumstances. While the objective of the shell company acquisition regime is to deny the possibility to buy a company just to benefit from existing tax loss carry-forwards, there is no 'motive test' that would provide for an exemption from the regime if the taxpayer can clearly demonstrate that the transactions were not tax-driven. Even clear business reasons for the transactions do not hinder the application of the regime. In general, the law does not provide for a certain time period in which the three criteria have to be fulfilled cumulatively. The fulfilment of all three criteria within a short time frame is a strong indication that a shell company acquisition took place. However, the relevant observation period may cover several years as long as the single steps can be considered to be parts of a larger plan to effect the relevant changes leading to the loss of the 'economic identity'.

Even if the conditions are fulfilled, the loss carry-forwards do not expire if the changes are made for purposes of a restructuring of the corporation with the goal of saving a substantial number of existing jobs and its trade or business (that is an 'escape clause'). A substantial number of jobs is generally given if 25 per cent of the employees are retained. Such exemption will thus usually not be met if a holding entity or a similar vehicle is restructured.

Given that loss carry-forwards do expire as a result of the loss of the 'economic identity', section 8, paragraph 4, No. 2, c of the Austrian Corporate Income Tax Act, stipulates a very important exemption: any taxable income arising from the substantial economic change (eg, sale of assets or business premises) in the year of loss of the 'economic identity' can be offset with the loss carry-forwards before they expire.

Acquisitions or restructurings of bankrupt or insolvent companies are not subject to any special rules or tax regimes in Austria, although cancellation of debt, which generally is taxable in Austria, may enjoy a reduced taxation if certain requirements are met.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Pursuant to section 11 of the Austrian Corporate Income Tax Act, interest – in a narrow sense – on funds used to finance the acquisition of shares is tax deductible for corporate income tax purposes.

Expenses related to the payment of interest to foreign recipients are in general deductible from the corporate income tax base. However, the deductibility of interest payments is limited in the case of loans between related parties. Accordingly, expenses with interest are not deductible from the tax base of an Austrian corporation as long as, cumulatively:

- the interest is paid to an Austrian company or a foreign company that is comparable to an Austrian company;
- the interest is paid to a company that is directly or indirectly part of the same group of companies or is influenced directly or indirectly by the same shareholder; and

- the interest payments in the state of residence of the receiving company are not subject to tax because of a personal or objective exemption:
  - subject to tax at a rate lower than 10 per cent; or
  - subject to an effective tax at a rate lower than 10 per cent due to any available tax reduction.

It is not relevant whether taxation at a rate lower than 10 per cent is based on the domestic law of the state of residence of the receiving company or the applicable double taxation treaty concluded between Austria and the respective state of residence. If the receiving entity is not the beneficial owner, the respective conditions have to be investigated at the level of the beneficial owner (eg, in certain back-to-back refinancing scenarios). Although not limited to cross-border payments in other jurisdictions, one should note that Austria, as of today, has no interest barrier rule. Accordingly, interest payments made to third (ie, unrelated) parties are always tax-deductible. However, as a result of the OECD BEPS project, it is notable that recently adopted EU legislation provides for such interest barrier rule to be implemented by the EU member states before and applied as of 1 January 2019. However, member states may postpone the implementation of such interest barrier rule until 2024 if they have equally effective measures in place. In this respect, it is currently being discussed whether the above described provision regarding the non-deductibility of interest payments to low-taxed group companies may be considered equally effective in order to avoid the application of the interest barrier rule as from 2019.

Despite the fact that there are no Austrian statutory rules on thin capitalisation, as a matter of administrative practice and under the case law, loans from related parties to an Austrian company may be considered to be 'hidden' equity and not debt if the Austrian corporation is considered to be thinly capitalised. A shareholder loan may be re-qualified as deemed equity in the following scenarios:

- lack of sufficient equity in relation to the long-term funding requirements of the business;
- excessive debt financing (debt to equity ratios far below the market standard);
- inability of the borrower to obtain a loan at comparable terms from third parties; or
- the loan agreement grants rights to the lender similar to those of shareholders.

In such a case, the interest is reclassified as dividends for Austrian tax purposes, but these deemed dividends may not, in some cases, benefit from treaty or directive reductions. While there is no official 'safe harbour' rule, the Austrian tax authorities generally accept debt-to-equity ratios of around 4:1 to 3:1. However, this can only serve as guidance and the adequate debt-to-equity ratio has to be analysed on a case-by-case basis. Having said that, higher debt-to-equity ratios have also been accepted.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Tax risks are usually covered by warranties or indemnities. Tax warranties typically foresee a time limitation around seven years. No liability is usually agreed for mere timing differences (eg, if tax authorities request longer tax depreciation periods) or if the tax risks had already been accounted for (eg, through provisions). Warranties are usually qualified by matters that have been disclosed (in a certain manner) or are deemed disclosed by operation of the provisions of the acquisition agreement or the disclosure letter. Indemnities are generally not qualified by disclosure or knowledge. The tax indemnity is usually only subject to a specific tax conduct provision, a direct loss limitation and the overall cap. In some cases additional protection is obtained by warranty and indemnity insurances. If a tax warranty or indemnity is triggered, the seller will usually have the right to pursue tax litigation at his or her own risk and expenses to mitigate a potential liability. Payments under tax warranties or indemnities result in a retroactive change as regards the profit or loss generated by the seller and the acquisition

costs recorded by the purchaser and thus have only indirect tax consequences, rather than being taxable as such. If, however, additional payments such as liquidated damages are agreed upon, these would be subject to tax by the recipient. There is generally no withholding tax on such payments.

## Post-acquisition planning

### 10 Restructuring

#### What post-acquisition restructuring, if any, is typically carried out and why?

Typical post-acquisition restructurings are the merger of the acquisition company with the target company or the establishment of an Austrian tax group (see question 3). Owing to corporate limitations, the implementation of such a merger is often not feasible. Accordingly, the following paragraphs focus on the establishment of an Austrian tax group.

Austrian companies have the possibility to establish a tax group with subsidiaries by jointly filing a group taxation application before the Austrian tax authorities. The advantages of a tax group are the off-setting of profits and losses within the group (including the losses of foreign group members) and earlier usage of tax loss carry-forwards and the deduction of interest expenses from operational income.

According to the Austrian group taxation regime, a group parent company can form a tax group with a subsidiary if the parent exercises financial control over the subsidiary (ie, the parent owns more than 50 per cent of the capital and voting power in the subsidiary). Group members can include resident companies and non-resident companies if they are resident in an EU member state or in a third state with which Austria has concluded a comprehensive administrative assistance agreement regarding the exchange of information.

With regard to Austrian group members, 100 per cent of the profit or loss of the company is taxed at the level of the parent company (irrespective of the participation held), while losses of non-resident group members are only attributed to the parent to the extent of the direct participation of another national group member or the parent company (profits are not attributed at all). Losses attributed to the Austrian parent company in the past have to be recovered in Austria if the non-resident group member offsets the losses with its own income in subsequent years or if the non-resident group member leaves the group. The foreign losses have to be calculated based on Austrian tax law but they can only be offset to the extent a loss exists, according to foreign tax law. Special rules for the recovery of losses apply in case of the liquidation of a non-resident group member. Additionally, foreign losses shall be deductible only to the extent of 75 per cent of the total profit generated by all domestic group members and the parent company.

In general, write-offs with regard to participations in group members are not tax deductible. For shares acquired in a new Austrian group member, there was the option to record a goodwill element from the acquisition and amortise this asset over 15 years, leading to an additional tax deduction. For shares acquired after 28 February 2014, this option is no longer available. Goodwill amortisations from transactions before that date can be continued, given that the goodwill amortisation influenced the purchase price of the shares.

Other potential post-acquisition reorganisations could be, for example, the change of the legal form (typically a conversion) or the combination of a part of the existing business with the purchased business, which usually would be implemented by a carve-out of the existing one and a combination with the purchased one, which could be implemented either through a straight spin-off by acquisition, or through a spin-off followed by a merger. Sometimes, post-acquisition reorganisations are also aimed at simplifying the structure, for example if two multinational companies are combined by merging the various local entities. In the cross-border context, another possible post-acquisition reorganisation is the conversion of a local subsidiary into a branch, which is usually implemented by cross-border mergers.

### 11 Spin-offs

#### Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

Within the scope of article VI of the Austrian Reorganisation Tax Act a spin-off of companies can be effected tax-neutral (ie, a rollover treatment is available). The spin-off qualifies only if it relates to:

- a business unit;
- a division of a business unit, a partnership interest with an active trade or business; or
- a qualifying interest in a corporation (at least 25 per cent of the share capital).

In a spin-off qualifying assets would be transferred from one company to one or more companies, while the transferring company continues to exist. In a split-off the transferring company dissolves without formal liquidation and ceases to exist. The property can be transferred to a newly established company (split-off by formation) or to an existing company (split-off by acquisition).

In general, the rules set forth in section 8, paragraph 4, No. 2, letter c of the Austrian Corporate Income Tax Act (as mentioned in question 7) also apply to any changes of the structure of a corporation in the course of a reorganisation, such as spin-offs. However, the Austrian Reorganisation Tax Act contains some special provisions supplementing the general rules. Basically, the net operating losses of the spun-off business are transferred to the receiving company as long as the assets that caused the transferred losses are also transferred and the scope of the transferred assets is comparable to the scope of the assets in the point in time when the losses occurred.

Under the provisions of the Austrian Reorganisation Tax Act an exemption from VAT applies. Stamp duties will usually not be triggered since the transfer of assets and liabilities is implemented by operation of law according to the principle of universal legal succession. Depending on the assets transferred, real estate transfer tax and registration duties may be triggered. There is no capital duty in Austria anymore.

### 12 Migration of residence

#### Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

There are no explicit statutory taxation rules or administrative guidelines (except one provision in connection with the creation or discontinuation of an international participation in the course of the cross-border migration of an Austrian company) that deal with the migration of an Austrian corporation. At the level of the migrating corporation, the following alternatives have been discussed. Some scholars argued in the older literature that the corporation is treated as if it were liquidated. According to section 19 of the Austrian Corporate Income Tax Act the liquidation surplus at the level of the company would be calculated as the difference between the net assets at the beginning of the liquidation period and the net assets at the end of the liquidation period according to the normal tax and accounting principles. Losses carried forward can be offset against the liquidation surplus without limitation. The distribution of the liquidation surplus and retained earnings of earlier years constitutes taxable income for the shareholders and is taxed at their level depending upon whether it is a company or an individual, resident in Austria or not. In the meantime, however, the prevailing opinion is of the view that no liquidation taxation is triggered. Based on income taxation rules, it then needs to be analysed whether assets are actually transferred in the course of the migration, in which case exit taxation would be triggered, or whether as a consequence of the migration certain assets are no longer taxable in Austria (eg, a goodwill that will usually be attributed to the place of effective management) and likewise would be subject to exit taxation. In case of migration to an EU or EEA member state with a comprehensive administrative assistance, the tax can – upon request of the taxpayer – be paid in seven annual instalments (or two annual instalments as regards the current assets).



### Update and trends

The Annual Tax Act 2018 implemented the standards set by the EC Anti-Tax Avoidance Directive, and the most significant change is the introduction of CFC rules for 'controlled foreign companies' and permanent establishments. According to these new provisions, specific non-distributed passive income (eg, interest payments, royalty payments, taxable dividend payments and income from the sale of shares, financial leasing income and activities of insurances and banks) of a controlled foreign subsidiary under certain conditions is included in the corporate tax base of the Austrian parent company by applying the CFC rule. The preconditions for such attribution of income of the foreign company are the subsidiary:

- is directly or indirectly controlled (50 per cent of voting rights or capital or rights to profit);
- is situated in a low-tax country (meaning that the effective corporate tax paid by the subsidiary is lower than 12.5 per cent considering the foreign income calculated based on Austrian tax law and the factual paid foreign tax; and
- does not carry out any significant economic activity in terms of personnel, equipment, assets and premises.

Low-taxed passive income will only be attributed to the Austrian parent company if it amounts to more than one-third of the income of the foreign company. To avoid any potential double taxation triggered by the CFC rules a tax credit for actually paid foreign taxes and a reduction of taxable capital gains by the amount of profits (forming part of such capital gain) that have already been subject to Austrian tax pursuant to the CFC rules are provided.

In addition, the previous switchover mechanism for portfolio participations has been adapted and applies to low-taxed passive income of qualified international participations and qualified portfolio investments of at least 5 per cent. As a result, the switchover to credit-method will be triggered if the foreign subsidiary predominantly achieves low-taxed passive income and if the CFC legislation is not applicable.

The new CFC rules as well as the amended switchover mechanism for portfolio participations apply for business years, starting 1 January 2019.

Furthermore, the Annual Tax Act 2018 introduced a legal definition of 'misuse/abuse' based on the EU Anti-Tax Avoidance Directive. Then, abuse shall be deemed to have occurred 'when a legal arrangement, which may include one or more steps, or a sequence of legal arrangements, is inappropriate in terms of economic purpose'. 'Inappropriate' are those arrangements that, disregarding the associated tax savings, no longer make sense, because the essential purpose or one of the essential purposes is to obtain a tax advantage, which is contrary to the aim or purpose of the applicable tax law. There is no abuse if there are valid economic reasons that reflect the economic reality.

Finally, the application of advance tax rulings has been extended and in addition to reorganisations, tax groups and transfer pricing, aspects of international law (as of 1 January 2019), VAT law (as of 1 January 2020) and a potential application of the abuse of law provisions (as of 1 January 2019) can be clarified in the course of this advance tax ruling procedure. Furthermore, tax authorities must answer a tax ruling request within a period of two months.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interest payments to non-Austrian corporations are generally not subject to withholding tax and, therefore, are not subject to limited tax liability in Austria. Interest payments to non-Austrian individuals may be subject to Austrian withholding tax at a rate of 27.5 per cent (or 25 per cent in case of interest payment from bank deposits and certain non-secured receivables against credit institutions) if paid by an Austrian paying agent (eg, an Austrian issuer of securities, Austrian credit institution or Austrian branch of a non-Austrian credit institution). However, if the debtor has neither its seat nor its place of business within Austria, interest payments are exempt from limited tax liability and withholding tax, even if paid by an Austrian paying agent. Relief from withholding tax may be granted under applicable tax treaties. With respect to interest payments made before 1 January 2017, it is notable that individuals being resident in another EU member state may, as an alternative to the above described domestic withholding tax, be subject to EU withholding tax at a rate of 35 per cent unless they provide proper documentation issued by the tax office of their state of residence in order to avoid such withholding. EU withholding tax was abolished as of 1 January 2017.

As of 1 January 2016, dividends paid to a non resident are subject to a withholding tax of 27.5 per cent (previously 25 per cent). A reduction or relief from withholding tax might be available based on a tax treaty or the EU Parent-Subsidiary Directive. According to the Austrian implementation of the Directive, there is no withholding tax on dividends if:

- the parent company has a form listed in the Directive;
- the parent company owns directly or indirectly at least 10 per cent of the capital in the subsidiary; and
- the shareholding has been held continuously for at least one year.

Given that certain documentation requirements are met, a reduction or relief can be granted at source. There is no relief at source in cases of potential tax avoidance through holding companies (ie, if the recipient is a company that does not have an active trade or business, employees and business premises). Companies can apply for a refund in that case. In the course of the refund procedure, the company has to provide evidence that the interposition of the company does not constitute an abusive arrangement. As a further option, a refund of withholding tax on dividends can be claimed by a foreign corporation to the extent that the Austrian payer is not relieved from its withholding obligation, so long

as the tax withheld is not creditable in the recipient's home state under a double taxation treaty.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

According to Austrian generally accepted accounting principles (GAAP), the balance sheet profit of a company can be sourced by the release of capital reserves paid in by the shareholder or by operating profits obtained by the company itself. Austrian tax law provides a different treatment for distributions of such balance sheet profits, whether they are made in the form of repayment of capital or as dividends. Repayments of capital are tax-neutral and do not trigger withholding tax. At the level of the company, such repayment of capital does not trigger any tax consequences under Austrian tax law. At the level of the shareholder a repayment of capital is treated as a reduction of the acquisition costs or book value of the participation. Such reduction leads to a taxable capital gain if the repaid amounts exceed the acquisition costs or book value for tax purposes of the participation.

To document the amount of capital contributions for tax purposes (which can be different from the equity according to Austrian GAAP), taxpayers have to record all capital contributions in a special tax account. As long as the contributions recorded in this account cover the amount of a planned profit distribution, the management of a company has the right to decide whether a distribution to all shareholders of the company shall be treated as a taxable dividend or a tax-neutral repayment of capital.

### Disposals (from the seller's perspective)

#### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The most common form of transaction relating to corporations clearly is the share deal, due to reasons that go way beyond the tax implications. In general, a purchaser usually wishes to acquire only the target, rather than the foreign holding entity as well. The purchase of partnership interests is treated as the purchase of the pro rata amount of the assets and liabilities of the partnership (ie, as an asset deal). Either form generally trigger taxation.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

The disposal of stock in an Austrian company by a non-resident company is subject to tax if the participation amounts to at least 1 per cent at any time within the preceding five years. Accordingly, such disposals will usually be taxable in Austria (by contrast capital gains realised by Austrian companies arising from the disposal of stock in foreign corporations will usually be exempt from taxation in Austria). Corporate income tax is assessed on such gains at the normal rate of 25 per cent. Taxation is eliminated, however, in most cases under an applicable double tax treaty. Some of the double tax treaties concluded with Austria include a special provision in connection with companies owning real estate located in Austria, and assign Austria the right to tax such capital gains.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

It is possible to transfer the shares in an Austrian company or of the business assets by the Austrian company in a tax-neutral way under the Austrian Reorganisation Tax Act. Therefore, if the requirements are met (among others the consideration that the shares or assets transferred must generally be shares in the acquiring company), rollover treatment is available. If the seller of a local corporation is an Austrian private foundation, taxation of capital gains in a sale transaction can be avoided if within 12 months an alternative investment is made and the realised capital gains (hidden reserves) of the sold participation are transferred to this new investment (by reducing the acquisition costs in such new participation) and thereby remain taxable.

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# Chile

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

In general, the Income Tax Law does not make distinctions between acquisitions of stock in a Chilean company or its business assets and liabilities. In both cases, the seller must report the income derived from the transaction and pay the corresponding income tax.

Nevertheless, the acquisition of tangible movable assets in a business asset acquisition may be subject to value added tax (VAT), which is 19 per cent of the price or value. The same treatment is provided in an acquisition of going concern.

The tax is economically borne by the purchaser and therefore added to the price. However, it is the seller that must declare and pay the VAT to the Treasury.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Under the general rules of the Income Tax Law, companies and entities obliged to determine their income under full accounting basis must update the value of their assets and liabilities using an inflation adjustment.

Step-up in basis may also occur when the acquiring company acquires all the shares or participation rights in the target company, and the law provides that the latter cannot continue and therefore is automatically dissolved. In this case, the goodwill (ie, the difference between the price of the investment made by the acquiring company and the book value of the target company) will increase the value of non-monetary assets of the target company up to their fair market value. If a difference still remains, the goodwill constitutes an intangible asset that can be amortised at the moment the company ends its activities or it is dissolved.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Chilean Income Tax Law provides the same conditions in respect of acquisitions regardless of the domicile of the purchaser. However, if there is a double tax convention applicable, it may be preferable to make the purchase through a company established abroad.

The rules on dividends and profits distributions, which were recently amended by the 2014 Tax Reform (in force since January 2016), provide that dividends and profit distributions paid to shareholders are subject to individual income tax (for individuals residents in Chile) or withholding tax (for non-residents). Residents in Chile may credit 100 per cent or 65 per cent of the corporate income tax

paid by the company making the distribution dependent upon the corporate income tax treatment applicable to the latter (full or partial integrated system). The general rule within Chilean borders is partial integration (ie, 65 per cent of credit).

The same rules are applicable to non-residents. However, if the shareholder is resident in a country that has a double tax convention with Chile, the credit provided by the Income Tax Law will be in full regardless of the corporate income tax treatment applicable to the company making the distribution.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

No, mergers and share exchanges are not common forms of acquisition in Chile. Although both are legal according to Chilean law, they usually take up a great deal of time and resources until they are fully executed.

From a tax perspective, the acquiring company may not assume the same tax situation as the merged company. Under the Income Tax Law, tax losses may only be used by the company that incurred in them and cannot be transferred to another company. The same principle is applicable to VAT credits or rights to refund under the Value Added Tax Law.

Accordingly, the loss of tax benefits usually discourages these kinds of operations. The most common forms of acquisition in Chile are the acquisition of stock or the acquisition of business assets.

### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

The Income Tax Law does not make any difference in the tax treatment of the acquisition of a company regardless of the type of consideration.

### 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

There are no documentary taxes applicable to the acquisition of stock in a Chilean company or its business assets. However, as mentioned in question 1, the acquisition of tangible movable business assets, fix assets or of an ongoing concern may be subject to VAT. The rate of this tax is 19 per cent of the price or value of the corresponding asset, except in the case of fix assets where the tax is determined excluding the value of land.

Stamp duties are applicable to loans depending on whether the loan is payable within a determined period or not. The tax rate applicable ranges between 0.332 per cent and 0.8 per cent.

### Update and trends

The government announced that is working in a tax reform aimed to simplify the current tax system. The general objectives of this new legislation are to boost the investment and growth, but no specific details regarding its content have been notified to the public.

The correspondent bill of law should be introduced for discussion to the Congress sometime during the 2018 second semester.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

In general there are no limitations on the use of net operating losses. In order to prove the origin of these losses to the tax authorities, all legal and commercial documentation supporting them must be kept.

However, if there has been a change in the ownership of the shares, participation rights or rights to profits in the company incurring in those losses, their use is subject to the following conditions: the company must continue to carry on its main business activity and the company must have sufficient capital assets or assets and resources to carry on its businesses at the moment of change in property. The above-mentioned limitations only apply when the change in the property rights or profit rights exceeds 50 per cent.

As to other tax benefits and credits, there are no limitations insofar as the entity using them is the company that generated them.

Finally, there are no special tax treatments provided in respect of acquisition or reorganisation of insolvent companies.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Income Tax Law does not provide interest relief for borrowings to acquire the target company. However, under general rules, deduction of interest derived from borrowings is allowed insofar as the borrowings are invested in the production of taxable income.

The deduction of interest paid in respect of a loan provided by a non-resident related party may be disallowed or limited under the transfer pricing rules provided in the Income Tax Law. These rules are applicable when the transactions are executed with related parties and they infringe the arm's length principle.

In addition, under thin capitalisation rules interests paid to foreign related parties may be subject to a withholding tax at a rate of 35 per cent if the target company's debts exceed the ratio 3:1 in respect of its equity.

Withholding taxes on interest payments cannot be avoided, but they may be significantly reduced down to 4 per cent if a loan is granted by a foreign financial institution, or to 5 per cent, 10 per cent or 15 per cent if a double tax convention is applicable.

Debt pushdown is not allowed under Chilean law. If a debt is delegated to the target company, there would not be interest relief for the target company. It won't be considered as an expense related to the production of taxable income.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

As in most commercial transactions, warranties and indemnities are the main protections used. These are usually documented in the business asset or in the stock purchase agreement.

Considering the nature of these protections, the payment usually repairs the damage derived from the infringement of the contract's obligations. Thus, they do not generate tax effects.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

In Chile, after the acquisition process it is quite common to amend the bylaws of the company to the acquirer's standards.

Sometimes the acquisition process is followed by an increase of the company's capital or the provision of a loan from the acquirer aimed at funding its current activities or investing in new projects, which were the reason to acquire the target company in the first place. Usually, new contributions or loans are materialised in accordance with the ratio established by the thin capitalisation rules.

Other restructuring operations may be the deletion or creation of divisions of the company, which will usually imply the termination of employees' contracts and new hiring.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Under the provisions of the Income Tax Law, spin-offs can be executed in the form of company division or constitution of a subsidiary without triggering transfer taxes insofar as the tax or financial value of the assets and liabilities transferred to the new company are maintained.

However, spin-offs are not entirely tax neutral. As mentioned in question 7, the use of losses, tax credits and other benefits is restricted to the taxpayer that produced them. Therefore, they cannot be transferred to the new entity.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Chilean Company Law does not authorise the migration of incorporated companies to abroad regardless of whether the foreign jurisdiction accepts the migration or not. From a Chilean perspective, companies are considered as Chilean residents if they are incorporated in Chile – 'incorporation theory'.

Thus, the only option to move or allocate part or the entire business activity of a company abroad is to incorporate a foreign subsidiary or liquidate the company and transfer its assets abroad. In the first scenario, the transfer of assets to the subsidiary may generate taxable income.

In the second scenario, the dissolution and liquidation of the company may imply the application of income taxes in respect of the taxable income earned in the current fiscal year and also in respect of the undistributed profits of the company.



**13 Interest and dividend payments**

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

The Chilean tax system is an integrated system. Under the general rules of the Income Tax Law, dividends and profit distributions paid to non-residents are subject to withholding tax at a rate of 35 per cent. The corporate income tax paid by the company making the distribution may be credited to the withholding tax in full when a double tax convention is applicable or up to 65 per cent in all other cases.

Double tax conventions signed by Chile do not reduce the withholding tax in respect of dividends insofar as the corporate income tax may be fully used as credit.

As to the payment of interest, the withholding tax rate is 35 per cent. If a double tax convention is applicable, this tax is reduced to the rate established in the treaty, which is usually 5 per cent, 10 per cent or 15 per cent.

However, if the payment is made to financial institutions, the Income Tax Law reduces the rate of this tax to 4 per cent.

**14 Tax-efficient extraction of profits**

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

As in many jurisdictions, the most efficient manner to extract profits from Chile is by way of using the benefits provided in double tax conventions. With the exception of dividends, which are a type of income in which Chile does not limit its taxation rights due to the integration system, the application of reduced taxes in respect of interests and royalties along with the possible non-application of taxes in respect of business profits (article 7 of the OECD Model) constitute a major advantage. The existence of a permanent establishment in Chile eliminates these benefits.

In the absence of double tax conventions, the payment of interest may be subject to a reduced rate of 4 per cent when the beneficiary of the income is a foreign financial institution. In addition, depending on the nature of the service, payment of fees may also be exempt from income tax according to the Income Tax Law.

**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The most common form of disposal utilised in Chile has been the disposal of stock in the local company. Before the modifications introduced to the Income Tax Law by the 2014 tax reforms, these transactions were subject to a special and more favourable tax treatment.

With the exception of disposal of companies whose shares are traded in the Chilean stock market, under which the capital gain is tax exempt, the special tax treatments for the disposal of all other type of shares were significantly reduced. Therefore, as of 2017 the income derived from most other transactions is subject to general tax rules.

Finally, another type of disposal is the indirect sale. This usually occurs when the object of the sale is the non-resident holding or parent company of the local company. Despite the fact that the transaction may be between non-resident parties under contracts not subject to Chilean Law, the application of income tax is not avoided. Article 10 of the Income Tax Law provides that if the underlying asset (ie, the local company) is situated in Chile, the income derived from the transaction is sourced in Chile and therefore taxable under Income Tax Law.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

According to the Income Tax Law, the disposal of stock in local companies may be exempt from income tax insofar as certain conditions are met. In general, the company's shares must have been acquired and sold on the Chilean stock market. In addition, a reduced non-resident withholding tax may be applicable if the buyer is a Chilean resident and a double tax convention is applicable.

There are no tax benefits for the disposal of stock in real property, energy and natural resource companies other than the abovementioned treatment.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

If the seller is an individual resident in Chile, under certain circumstances the Income Tax Law permits him or her to choose between declaring the income on an accrued or perceived basis. If the price is paid in instalments and the seller has chosen to declare the income on a perceived basis, he or she will be able to defer the income tax.

If, on the other hand, the seller is a company or other entity (resident or non-resident), there is no method for deferring or avoiding tax. Under general rules, the resident seller of either shares in the local company or business assets obtains a taxable income from such transaction and must comply with all tax obligations no later than 30 April of the year following the year in which the income was accrued or perceived, whichever occurs earlier.

In transactions where the seller is not resident in Chile and the purchaser is a resident in Chile, the Income Tax Law provides that the latter must withhold a 35 per cent tax over the price or over the capital gain (if it is known). The withholding tax rate may be lower in cases where a double tax convention is applicable. Regardless of the application of

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withholding tax, the seller is obliged to file a tax return according to general rules.

Finally, in transactions where both the seller and the purchaser are not resident in Chile the Income Tax Law provides that the obligation to declare and pay income tax corresponds to the seller. This situation does not include the indirect sale (the sale of a non-resident holding company of a local company). In these cases, it is the purchaser who is the party obliged to withhold the tax applicable to the transaction if the seller is not resident in Chile.

# Colombia

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The relevant differences relate to VAT treatment. Before the enactment of Law 1819/2016, the main difference was the possibility of effectively amortising the assets, if the acquisition was made on an asset-by-asset basis. New tax rules state that the amortisation of goodwill, either in the acquisition of stock or assets will be part of the tax basis of the stock or assets.

The transfer of shares is not subject to VAT. Conversely, assets deals trigger VAT at a 19 per cent rate when the assets are disposed. The transfer of fixed assets is not subject to VAT, including intangibles formed or acquired by the taxpayer and that are not transferred in the ordinary course of business. In an acquisition made through an asset deal, each asset must be duly identified and transferred individually to determine the applicable taxation. Even if the transaction is structured as the transfer of a going concern, the tax analysis should be carried out on an asset-by-asset basis.

In Colombia, the International Financial Reporting Standards (IFRS) were adopted for local accounting purposes, thus some entities (entities listed in the Colombian stock exchange, public entities and among other taxpayers) should apply the IFRS Full and some others (the SMEs) should apply the IFRS for SMEs.

Under IFRS both the shares and the business acquisitions through a transaction providing control to the acquirer require the recognition of goodwill (no matter if the acquirer applying the IFRS is a resident entity or non-resident entity), which is not amortisable (as per IFRS Full only). However, the goodwill arising from the acquisition of shares is only recognised at the level of the acquirer's consolidated financial statements; in its separate financial statement the whole payment for the shares acquisition should be recognised as cost of the shares, thus a goodwill is not recognised. Said goodwill, assets acquired through a business acquisition and the shares are subject to accounting for the impairment of assets.

As for income tax purposes, the goodwill is not amortisable nor is the impairment of assets acceptable; it is important for the taxpayer to control and consider in its tax planning the related differences between the tax and the accounting basis, to minimise or optimise effects of double taxation that usually arise from said basis differences.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

The step-up in basis could be achieved in stock deals and asset deals. The general rule is that tax basis corresponds to the assets acquisition price, plus improvements, minus depreciations and amortisations. In addition, in the case of fixed assets, the taxpayer is entitled to increase the tax basis by inflation adjustments authorised by the government.

Regarding real estate, there is an alternative tax basis. The Colombian Tax Code includes the possibility of increasing the tax basis of municipal real estate taxes and taking that tax basis for income tax purposes, minus the accumulated depreciation applied as income tax deduction. The rationale behind this step-up in basis rule is to increase the municipalities' tax collection and in consideration for it, taxpayers could use a tax basis higher than the acquisition price of the real estate as tax basis in the disposal of such assets.

The formal requirements that have to be met in order to correctly apply the step-up rule implies at least two fiscal years. Thus, its implementation has to be opportunely planned. Real estate tax rates vary depending on the municipality, but the rates range between 0.3 per cent and 3 per cent.

For IFRS, the entity has the option to reevaluate its property, plant and equipment, intangible assets (with the exception of goodwill), and investment property as long as their fair value can be measured reliably. However, in assessing this option, the entity should control and consider in its tax planning any difference between the tax and the accounting basis in order to minimise or optimise the effects of double taxation that usually arise from said basis differences.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

There are no tax advantages of acquiring the target company through another Colombian company. In fact, that kind of investment structure could create cash trapping issues, because dividends could only be paid after a fiscal year ends and the annual shareholders' meetings are held. The fiscal year in Colombia is the same as the calendar year and normally ordinary shareholders' meetings are held in March.

It is ideal to invest through an entity that could benefit from the application of a double taxation convention in force with Colombia. Currently our treaty network includes Canada, Chile, Czech Republic, India, Mexico, Portugal, South Korea, Spain and Switzerland.

Another incentive to invest through a foreign entity is that an indirect transfer of shares is not a taxable event for foreign investors without tax residence in Colombia. Therefore, double holding international structures are commonly used to invest and acquire investments in Colombia.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Mergers and spin-offs are common acquisition tools. The reason is that our current tax law provides that these forms of corporate reorganisation are tax neutral, meaning that mergers and spin-offs are not considered as transfer or alienation of stock under certain circumstances.

If formal and substantial requirements are met, taxation is deferred until the disposal of the shares or assets subject to the merger or spin-off. Tax neutrality applies to both income tax and VAT.

It is relevant to mention that after the neutral merger or spin-off takes place, there is a two-year holding period requirement that needs to be met. If it is not observed, the tax effects could be more

burdensome than those that would be applicable if the transaction was not considered neutral.

For IFRS purposes, it is important to highlight that when through a business combination (arising from mergers or spin-offs) the control of the acquired company is obtained, the acquirer should use the acquisition method to recognise said business combination. This means that the assets and liabilities of the acquired entity should be measured at their fair value for recognition purposes. As the tax assets and liabilities are measured at cost in neutral mergers and spin-offs, the differences between the tax and accounting basis should be controlled and considered in the acquirer's tax planning in order to minimise or optimise the effects of double taxation that usually arise from said basis differences.

## 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

There is no benefit from the tax perspective.

## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

The sale of shares in a corporation or simplified stock corporation is not subject to transactional taxes. The transfer of quotas in a limited liability company is subject to registration tax and notary fees of a 1 per cent rate, approximately.

In the case of an asset-by-asset deal, VAT may be triggered as VAT is triggered on the import and transfer of tangible movable goods and the provision of services within Colombian territory. According to the above, the sale of fixed assets and intangible property does not generate any VAT.

In the case of the transfer of a going concern, as it is not properly a movable good, in principle, its transfer should not trigger VAT. Nevertheless, the tax administration doctrine has understood that the sale of a going concern does actually trigger VAT, given that it implies the transfer of property of movable goods. Therefore, even if a going concern is being transferred, the sale would have to be made on an item-by-item basis as it occurs with income tax.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Net operating losses (NOLs) generated until fiscal year 2016 can be carried forward without amount or time limitation. However, if the company is merged or spun-off, the NOLs can only be offset if the absorbing or resulting company has the same economic activity as the one that generated the NOLs. Additionally, in these cases NOLs can only be offset in the proportion of the equity that the company represents in the absorbing or resulting company. NOLs generated as of fiscal year 2017 can be carried forward with a 12-year limitation.

Regarding the bankruptcy regime, there are two special rules. In Colombia, income tax basis is determined as the higher between two methods: the ordinary income method and the presumptive income method. The first one is the result of determining the net income (income less costs and expenses); the second is calculated as 3.5 per cent of the taxpayer's equity of the prior fiscal year.

Taxpayers that benefit from the bankruptcy regime are not subject to income tax under the presumptive income method for three years. In addition, taxpayers under such regime can claim on a quarterly basis the refund of income tax withholdings.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

The current tax authorities' position is that interests on debt loans for the acquisition of shares are deductible. This deduction is applicable if the interest payment is made by a Colombian entity. When the lender is a foreign entity, the payment or accrual of the interests should be subject to income tax withholding and comply with Colombian exchange rules as a deductibility requirement. In addition, if the lender is a related party, transfer pricing rules should be observed.

The income tax withholding rate will depend on the loan term. Interest payments on loans granted for more than one year are subject to income tax withholding at a 14 per cent rate upon gross payment. Interest payments on loans granted for less than a year are subject to income tax withholding at a 33 per cent rate upon gross payment.

Taxpayers are only able to deduct interest generated by credit loans (debt) whose total average amount during the taxable period is not greater than three times the taxpayer's net worth as determined on 31 December of the previous fiscal year.

Based on these rules, interest paid on loans that exceed a 3:1 debt-to-equity ratio when compared with the equity of the taxpayer as of the last day of the previous tax year shall not be deductible. Only interest-bearing loans shall be taken into account for the calculation.

These rules apply even if the lenders are financial institutions and it is irrelevant if the lenders are related parties or not. Apart from the thin capitalisation rules, in order to be deductible interest payments have to be necessary, proportional and have a cause-effect relation with the income producing activity. Moreover, if the loans are granted by a non-resident related party, the loans would be subject to the Colombian transfer pricing regime.

Acquisition debt may be subject to a pushdown into the Colombian entity or another entity as a result of reorganisation in Colombia with no restriction.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Forms of protection of investments are very wide: warranties, indemnities and tax covenants are usually included in stock sale and purchase agreements, memoranda of understanding or letters of intention. If claims relate to indemnifications, they are not taxed in the portion of the indemnification corresponding to damages not to be considered as loss of profits. Loss of profits is taxed as ordinary income.

Another possibility is to gross up the transaction's price, but depending on how the adjustment is structured, it could be considered as taxable income for the claimer.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

From the tax perspective, restructuring should be conducted and planned before executing the acquisition.

**11 Spin-offs**

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

As mentioned above, spin-offs are tax neutral if certain requirements are met. The NOLs can be offset to the extent the absorbing or resulting entity has the same economic activity of the entity that generated the NOLs. NOLs can only be offset in the portion of equity that the spin-off entity represents in the absorbing or resulting entity.

**12 Migration of residence**

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

This procedure is not possible in Colombia.

**13 Interest and dividend payments**

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interests are subject to a 15 per cent income tax withholding. A reduced 5 per cent rate is applicable to certain infrastructure projects. These income tax withholdings may be reduced with the application of double taxation conventions. Until 31 December 2016, dividends were not subject to income tax, as long as they were paid out of taxed profits; if the dividends were not taxed at the corporate level the applicable rate was 33 per cent. As of the year 2017, dividend distributions paid out from taxed profits are subject to a 5 per cent withholding tax. Dividends paid out from untaxed profits are subject to a 35 per cent withholding tax; in this case, an additional 5 per cent income tax withholding would apply on the dividend, net from the 35 per cent income tax withholding.

**14 Tax-efficient extraction of profits**

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Some tax-efficient measures include income from services or intangibles. A 15 per cent income withholding tax rates are applicable in the provision of technical services, technical assistance and consulting services and on royalties. In the context of a double taxation, convention may allow the application of a 10 per cent reduced rate. In any tax strategy to extract profit it is important to observe Colombian anti-avoidance rules. According to the current regime, any transaction, action or legal structure may be declared abusive under article 869 of the Colombian Tax Code (CTC), disregarding the tax effects applied by the taxpayer and recharacterising the transaction for tax purposes.

In this case, it is possible that the income obtained by the entities that are part of the corporate structure is considered as income obtained directly by the ultimate beneficiaries of the same, as the Tax Office may lift the corporate veil of the entities that are part of said corporate structure or the transactions carried out.

Therefore, abuse implies the use or implementation of any type of artificial legal action or proceeding, without an economic or commercial purpose, in order to alter, disfigure or artificially modify the tax effects that would otherwise be generated for one or more taxpayers or their related parties, shareholders or beneficiaries with the sole purpose of obtaining a tax benefit (such as tax eliminations, reductions, deferrals, exemptions, etc). As per article 869 of the CTC, there would be an artificial legal action or a lack of economic or commercial purpose in a transaction if it is evident, among other circumstances, that: it is not reasonable from an economic perspective; it entails a high tax benefit; or it involves an apparent valid legal act or business.

Additionally, if a transaction is considered to be abusive, the person who made, participated in or facilitated actions of fraud or abuse will be jointly and severally liable before the Colombian tax office (DIAN) for the obligations derived of said acts or structures and for damages caused. The declaration of invalidity of actions of fraud or abuse, and the action for compensation for damages arising from the respective acts will be analysed by DIAN through an audit procedure.

With regard to the application of the anti-avoidance rule, it is important to mention that this provision introduces a penalty regime whenever a situation of abuse occurs. As the Colombian legality principle requires that an applicable penalty must exist at the date of occurrence of the situation that may generate the penalty, the anti-avoidance rule can only apply to new facts or strategies implemented or modified after the enforceability of this provision.

**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

All of these are usually implemented. If there is an international structure the disposal can be implemented as indirect transfers of ownership due to the fact that these operations are not taxable in Colombia. Stock and asset deals are usually implemented too. Capital gains tax rate is 10 per cent if the asset or stock has been held for two years or more and the taxable base is the difference between the selling price and the tax basis. If the two-year holding period is not observed, the ordinary income rate would be applicable. Therefore, the applicable rate is 34 per cent for fiscal year 2017, 33 as of fiscal year 2018.

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**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax?  
Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

The disposal of stock by a non-resident company is taxed as capital gains at a 10 per cent rate. Taxable base is the difference between the selling price and the tax basis of the shares. This rate is applicable to the extent the shares were held for a period equal to or higher than two years. If they were not, the transaction is taxed as ordinary income.

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**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

No.



# Curaçao

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

#### Acquisition of assets

The buyer can purchase the assets and liabilities of the target in Curaçao. In such a case, the buying company may value the assets and liabilities, including goodwill, at fair market value. When real estate is purchased with the asset transaction, 4 per cent real estate transfer tax is due. No sales tax is due on the acquisition of assets provided it concerns the acquisition of a business or independent part of a business.

#### Acquisition of shares

The participation exemption rules are important tools in Curaçao M&A practice. As explained in question 3, the proceeds, upon acquisition of shares from another Curaçao company, may be tax exempt at the seller's side provided certain conditions are met.

In the case of acquisition of shares of another Curaçao company, the use of a Curaçao acquisition vehicle is recommended as fiscal unity can be formed upon acquisition of 99 per cent of the shares in the Curaçao target. As a result of the fiscal unity, the parent company can set off its interest expenses of acquisition loans provided certain conditions are met.

The acquired subsidiary continues with the book value of its assets.

The acquisition of real estate companies is, contrary to the Netherlands law, not subject to real estate transfer tax. The acquisition of shares is not subject to sales tax in Curaçao.

The shares purchased are booked against the purchase price. No tax deductible amortisation of goodwill is possible when the participation exemption rules apply with the acquiring company.

#### Domestic acquisitions

The acquisition of a domestic target is preferably executed through a local holding company in order to form a fiscal unity. If the acquisition is financed, the interest can be set off against the operational results of the target, though anti-abuse measures exist.

Domestic acquisitions of companies in certain industries can be executed by using the treaties to promote economic activities between Curaçao and Denmark, Sweden and Finland, granting certain tax advantages in those countries, among others exemption of dividends distributed to these countries. It is not quite clear whether it concerns a direct investment of a company resident in those countries or whether it would also apply to foreign companies investing in Curaçao through intermediary holdings in those countries.

#### Foreign acquisitions

It may be beneficial to use a Curaçao holding in order to acquire a foreign target for the following reasons:

- asset protection possibilities – Curaçao, as a country within the kingdom of the Netherlands, is party to more than 90 bilateral investments treaties;
- through its participation exemption rules, dividends received and capital gains realised with the alienation of shares are exempt provided that certain conditions are met;

- Curaçao levies no withholding taxes;
- advantageous possibilities to create group finance companies and IP structures;
- access to the Dutch treaty network by using a Dutch intermediary holding. Under the new Tax Arrangement of the Kingdom, the Tax Arrangement Netherlands Curaçao, which has come into force as of 1 January 2016, no dividend withholding tax is due provided the limitations of benefit clauses are not applicable or an appeal can be made on the safety net provision;
- access to the Spanish treaty network by using a Spanish holding qualifying for the Spanish ETVE (for holding companies) regime. Spain does not levy Spanish dividend withholding tax on dividend distributions to Curaçao; and
- access to the Norwegian treaty network by using the Curaçao-Norwegian tax treaty.

US companies should be able to use the Curaçao fiscal unity rules (and create BV1-BV2 structures) for their foreign acquisitions, though it depends on the country where the target is located.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

As mentioned, in asset transactions the buyer is allowed to account for the assets and liabilities at fair market value, which creates a higher amortisation base. Goodwill can be amortised, generally in five years, other assets in three to five or 10 years. As of 1 January 2016, the accelerated amortisation is no longer allowed. As per the same date the depreciation rules for real estate have been amended. Broadly speaking, no depreciation of real estate is allowed for real estate investments if the real estate value is lower than the real estate value for real estate taxes.

An investment deduction for tangible assets is available provided certain conditions are met. The investment deduction is 10 per cent of the acquisition value of the tangible assets. For real estate the investment deduction is 15 per cent. Disinvestments within six years, respectively 15 years (real estate) as of the year of investment, result in an addition of 10 or 15 per cent of the disinvestment amount.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Several tax advantages could be realised in the case of an acquisition of a business in Curaçao by an acquisition company in Curaçao.

Under the national ordinance tax benefits investments, tax advantages such as a reduction of the profit tax to 2 per cent, exemption for real estate taxes and custom duties can be granted provided that certain conditions are met. Investments in certain branches, such as tourism, project development, healthcare, and industries such as R&D, high tech, and the agriculture industry are stimulated by these provisions. Existing companies acquired may also benefit from these rules provided that certain minimum investments are made.

In addition, the Curaçao participation exemption rules may apply. This may be of particular importance in the case of the acquisition of shares in a domestic or foreign target. Under the participation exemption rules, dividends received and capital gains realised with the alienation of shares are exempt from taxes provided the following conditions are met: the Curaçao parent company holds at least an interest of 5 per cent or more in the nominal paid in capital in the subsidiary, or 5 per cent of the certificates of participation in a mutual fund; or the Curaçao parent company is a member of a Cooperative Association.

The participation exemption includes a corresponding holding of profit-sharing certificates.

Note that not only the dividends and capital gains are exempt, but that also expenses, including foreign exchange results, directly or indirectly related with the participation are not deductible, unless these expenses are indirectly instrumental in making profits in Curaçao. This means that only certain expenses in connection with a domestic participation are deductible.

#### Interests less than 5 per cent

The Curaçao parent company that holds less than 5 per cent of the nominal paid in capital but has paid at least US\$500,000 for its participation also qualifies for the Curaçao participation exemption.

#### No quantitative demands for interests in cooperatives

Note that, contrary to the holding of shares in another company, no quantitative demands are applicable in case of a membership in a cooperative. The membership alone is sufficient.

#### Anti-abuse measure passive subsidiaries

Under the anti-abuse measure, a 10th part of the dividend income received from subsidiaries that qualify for the participation exemption is taken into account if the following cumulative conditions are met: the gross income of the subsidiary, derived from investments comprises more than 50 per cent of dividends, royalties or interest received outside the framework of an enterprise it operates, has acquired or has alienated; and the subsidiary is not subject to a nominal tax rate of 10 per cent. These demands are hereafter referred to as the activity test and subject to tax test.

Note that capital gains are always fully tax exempt provided that the conditions of the participation exemption rules are met.

The activity and subject to tax tests may be determined on the consolidated gross income on the consolidated profit of the subsidiary. Participations held by the subsidiary that are not consolidated in the statutory financial statements may be considered as if they were tax transparent in determining whether the activity and subject to tax tests are met. On request, the activity and subject to tax tests may be determined on the basis of the average taxable profit of the last two years.

#### Tax-free repatriation profits in case anti-abuse rules apply

The profit tax ordinance contains a definition of dividends. As a result it will be possible to obtain income free from taxes from a participation that does not qualify for the full Curaçao participation exemption by way of repayment of capital, (partial) liquidation and repurchase of shares.

#### Real estate companies

The activity test and subject to tax test are not applicable on dividend income of a participation of which the assets consist, directly or indirectly, of 90 per cent of more of real estate.

#### Other anti-abuse rules

The participation exemption rules contain anti-abuse rules when receivables held by the Curaçao parent company have been amortised by the parent company and are converted into capital, or when they have been sold or transferred to a non-resident.

#### Earn-out arrangement and participation exemption rules

In the M&A practice it is not uncommon that (a part of) the purchase price for shares in the acquired company is paid under an earn-out arrangement. Under an earn-out arrangement, the sellers are paid an additional sum that is based on future earnings of the acquired company.

According to the decision of the Dutch Supreme Court of 30 June 1999, BNB 1999/139 additional payments under an earn-out arrangement do not qualify for the participation exemption. According to the

Supreme Court decision, both the buyer and the seller have to make an estimate of the expected obligation respectively receivable of the future payments to be made or received under the earn-out arrangement. The buyer would like to value the obligation as low as possible, as additional payments are deductible, whereas the seller would like to value his or her receivables as high as possible as payments received exceeding the receivables are taxable. In addition, Curaçao does not levy any withholding tax on dividends, interest and royalties.

## 4 Company mergers and share exchanges

### Are company mergers or share exchanges common forms of acquisition?

#### Enterprise mergers (shares in exchange for assets)

The Curaçao profit tax ordinance contains enterprise merger rules under which the acquisition of assets that form a business or independent business in exchange of shares in the company that acquires the assets and liabilities are facilitated.

The enterprise merger rules are especially interesting for the transfer of family-owned businesses where the business is transferred from one generation to another.

The enterprise merger can also be used to merge the assets of two businesses and create holding companies of the original entities.

Characteristic of the enterprise merger is that the assets and liabilities, which have to form a business or part of an independent part of a business, are transferred to a new entity in exchange for shares in the new entity. The contributing entity becomes a holding company, provided certain conditions are met. No taxes are levied at the time of the merger. The tax claim is preserved as the new entity continues the book value of assets received. Therefore, the new company that acquires the assets and liabilities cannot account for goodwill or revalue assets.

The tax not levied at the time of the merger will be levied when the shares issued are sold within three years after the enterprise merger.

A special form of the enterprise merger is where the assets and liabilities that form a business or independent part of a business are transferred in exchange for cumulative preference shares. As a result, it is possible to transfer all business assets to a new company in exchange for cumulative preference shares placed with the company of the contributor of the assets. Nominal shares are, for example, placed with a company incorporated by a third party, the acquiring party. After three years, the cumulative preference shares can be repurchased as a result of which the company is fully owned by the company of the third party. The proceeds of the repurchase of the cumulative preference shares are not taxable under the participation exemption rules.

The enterprise merger can take place without prior approval of the tax authorities if the following conditions are met:

- the enterprise merger must contain the transition of a business or assets that are considered an independent business;
- the transition of assets must take place in the context of a merger;
- the acquiring party may not have losses that can be carried forward;
- the tax claim on the assets must be secured (realised by continuing with the book value);
- the transition of assets must take place against exchange of shares in the acquiring company;
- the shares acquired with the merger may not be sold within three years; and
- for the purpose of determining the profit, both companies must use the same system of profit determining. This implicates that the merger is not possible in case one of the companies is subject to, for example, a special regime.

'Standard conditions' have been published under which the enterprise merger can take place if one of the seven conditions mentioned above are not met. In such a case, a request must be filed with the tax authorities and the enterprise merger can only take place after the approval of the tax authorities.

#### Share exchange (shares for shares)

In a share merger a company is taken over by an acquisition of its shares in exchange for shares in the acquiring company.

The tax facility rules regarding share exchange, merger, demerger and conversion rules were introduced on 1 January 2017. With respect to the share merger, these tax facility rules have replaced the old share

exchange directive based upon which a tax facilitated share exchange was already possible.

Under the provisions for the share exchange, the profit realised with the exchange of shares does not have to be taken into account, unless the acquirer also pays a cash remuneration. Under the provisions for share exchange, share exchanges in the following situations are facilitated when:

- a Curaçao company acquires, in exchange for its own shares, sufficient shares in another Curaçao company that it has more than 50 per cent of the voting rights in the company acquired;
- a Curaçao company acquires, in exchange for its own shares, such a number of shares in a foreign company that it has all, or almost all (ie, 90 per cent or more) of the voting rights of the foreign company acquired; or
- if a Curaçao company already possesses shares in a Curaçao company that represents more than 50 per cent of the voting rights or such a number of shares in a foreign company that represents more than 90 per cent of the voting rights and scope of the voting rights are extended by the share merger.

An advantage of the share exchange is that there is hardly a need for cash. The rules only allow limited cash payments (10 per cent) in case of a share exchange.

The provision also contains a general anti-abuse provision. The share exchange provision is not applicable when the share exchange is aimed at avoiding taxes or postponing taxes. Such will be the case if the share exchange is not based on business motives such as reorganisation, restructuring or rationalisation of the businesses of the companies involved.

A share exchange can be of use in the case of the reverse takeover, where public listing is sought.

There are some companies that are still listed but hardly have any activities. Such companies are sometimes used to acquire shares in the company that seeks a listing in exchange for shares in the already listed company.

The rules also provide for bypassing the tax claim in the case of individual shareholders who are considered substantial interest holders.

The share exchange rules are especially useful to the shareholders with a substantial interest in the company that is going to exchange its shares for shares in the acquiring company. Under the share exchange rules, the substantial interest is not levied but the tax claim is passed on to the shares received. The tax claim is preserved by passing on the original cost-price of the shares to the shares obtained in the acquiring company.

Briefly, an individual is considered to have a substantial interest when he or she, whether or not together with a spouse, possesses 5 per cent or more of the shares. Under the substantial interest rules, individuals are taxed for their dividends as well as capital gains. Foreign individuals are generally not taxed under the substantial interest rules, unless they receive income from their substantial interest within 10 years after being a resident of Curaçao.

The share exchange rules are also advantageous for creating joint ventures.

### Legal merger and demerger

As of 1 March 2004, the Curaçao Civil Code (CCC) contains merger, demerger and conversion rules, but the tax rules that facilitate mergers, demergers and conversions have only been implemented since 1 January 2017.

A tax neutral merger (and demerger) is possible provided the following four conditions are met:

- both the acquiring and disappearing company may not have any losses that are eligible for carry forward;
- both companies have the same system for profit determination;
- the tax claim on the assets must be secured (realised by continuing with the book value); and
- the merger must be based on sound business reasons (see share exchange above).

In case the four conditions mentioned above are not met, a facilitated merger or demerger can take place on request. Standard conditions are published with demands that must be met.

In both the share exchange and legal merger, the companies continue with the original cost-price of the assets and, contrary to an asset transaction, no tax is levied upon acquiring assets through a merger.

The merger rules of the CCC allow an inbound cross-border merger in which a foreign legal entity is the disappearing entity (provided that foreign law allows such merger) and an outbound cross-border merger where the Curaçao legal entity is the disappearing entity, though the tax facility rules only facilitate a domestic merger as the standard conditions only apply for mergers when both companies are located in Curaçao.

As with the share exchange, the merger rules also contain a facility in case the shareholders are individuals with a substantial interest.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

With a consideration paid in cash, the acquirer may wish to consider whether he or she can offset interest payments against operational profits, especially when the purchase price for the stock is borrowed. This can be realised through a fiscal unity between a Curaçao acquisition company and a Curaçao target. Alternatively, it could also be realised between a Curaçao acquisition company and Curaçao target in which the target applies for the tax transparent status. An existing company, provided certain conditions are met, can apply for a tax transparent status before the end of the book year or within three months after the start of the new book year. In both cases the tax transparent status commences as per the new book year. In both cases the interest payments of the acquiring company can be set off against the operational profits of the target, either through consolidation (fiscal unity) or, in the case of transparency, because the results are accounted for at the level of the parent company.

Curaçao does not levy any capital taxes and therefore it does not make a difference whether an acquisition is cash or shares. A point of attention may be the foreign exchange licence fee of 1 per cent levied by the Central Bank of Curaçao and St Marten when the acquiring company is not in possession of a dispensation of the foreign exchange licence.

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

No stamp taxes are due upon the acquisition of shares. The same goes for the asset transaction.

Curaçao does not levy any capital duties upon issuing of new shares or when shares are paid in.

No sales tax (VAT) is due upon the transfer of shares or the transfer of assets and liabilities that constitute a business or independent part of a business.

Real estate transfer tax is due when real estate is acquired under an asset transaction. As of 1 January 2017, exemptions for real estate transfer tax apply in case of mergers and demergers.

Stamp tax amounting to not more than US\$5.60 per page of document and registration tax of US\$ 2.80 per document are payable in the case of registration in Curaçao of documents or if such documents are brought into the courts of Curaçao and court fees will be due in the case of litigation in the courts of Curaçao.

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Losses of a company can be carried forward for a period of 10 years.

In case of an asset transaction, the losses stay behind with the selling company, which can use them to set off the capital gain realised with the sale of the assets.



### Update and trends

To comply with the BEPS Rule 5, the profit tax ordinance has been amended as per 1 July 2018. The regime for the economic zone has been reformed and can only be used for physical trading, warehousing and certain services such as repair and maintenance services on assets that are brought into the economic zone or assets that are located abroad.

A new territorial foreign profit regime has been introduced for delivery of goods and performing services to non-resident customers, which exempts the profit realised provided certain conditions are met.

As of 1 July 2018, substance rules have been included in the profit tax ordinance.

Loss compensation can be continued in the case of a transfer of shares provided that the activities of the company acquired have not ceased or nearly ceased, in which case the losses cannot be compensated with new activities developed by the new shareholders. However, this anti-abuse rule is not applicable in cases when these profits are put mainly at the disposal of individuals who were also shareholders at the time when the activities ceased. The words 'mainly at the disposal' mean that at least 70 per cent of the shareholders must also be shareholders in the new situation.

Disinvestment premiums may be due by the seller in cases when the seller has claimed an investment deduction and the sale of the assets takes place within five years following the year of claiming the investment deduction. With real estate, the disinvestment period is 15 years.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interest is generally deductible. However, the Curaçao profit tax ordinance contains several anti-abuse measures including that interest and other remunerations paid for the use of assets to other group companies are not deductible if the remuneration is not at arm's length. Also, interest, including foreign exchange results, paid to a tax exempt group company, whether domestic or foreign, is not deductible if the average debt in a book year exceeds one-third of the equity of the borrower.

Furthermore, the Curaçao profit tax ordinance contains measures that prevent base erosion. Under these measures, no interest paid to group companies is deductible if the debt is related to: (i) profit distributions and repayment of capital; (ii) the acquisition of shares, certificates of participation or membership rights in companies belonging to the same group and established in one of the other countries under the domain of the Netherlands or in a country with which Curaçao has entered into a tax treaty except and insofar as a change is made in the ultimate interest and control of that company; or (iii) a capital contribution by the taxpayer in the company to which the contribution is indebted.

However, the anti-abuse measures under (i) to (iii) above are not applicable when the loan is based on business reasons or the interest received by the lender is taxed at a rate that is considered to be reasonable for Curaçao tax purposes (10 per cent).

Debts that fall within the reach of (i) through (iii) above are not taken into account in cases when the interest is already not deductible as a result of the fact that it is paid to a foreign or domestic tax-exempt group company and the average loan during the book year exceeds one-third of the equity of the debtor.

Furthermore, thin cap rules 1:3 apply on payments made to related group companies that are not subject to tax (ie, interest is not deductible in as far as the debt exceeds three times the equity of the debtor). To determine whether interest is deductible or not, the base erosion rules I through III must be applied first. If the interest is deductible according to the rules I through III, then the deductibility might be prevented

by the thin cap rules. The thin cap rule is only applicable if moneys are borrowed from group companies.

As mentioned above, using a domestic company to take over the shares in another domestic company can be advantageous, as under the fiscal unity rules the interest can be set off against the operational results of the acquired company. The above-mentioned anti-abuse rules also apply in case of a fiscal unity.

The main rule within the fiscal unity is that interest paid on inter-company loans entered into for the acquisition of shares in the subsidiary is only deductible if the interest amount does not exceed the profit of the parent that it would have realised without a fiscal unity or interest deduction.

However, loans related to the acquisition of shares stay deductible within the fiscal unity: in as far as the group company that has granted the loan to acquire the shares has taken up a loan with non-related parties (banks etc); or if the parent company in the fiscal unity can prove that the ultimate interest in the subsidiary has been changed; or if the parent company in the fiscal unity can prove that the reasons for the loan agreement are not tax evasion.

As the rebuttal rules mentioned above are also applicable, the interest paid to group companies is also deductible in cases when the interest received by the lender is taxed at a rate that is considered reasonable for Curaçao tax purposes.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

When shares are purchased, the seller and buyer often agree upon a full indemnity by the buyer for tax costs relating to the pre-acquisition period and that are not included in the acquisition balance sheet.

If the acquired company formed part of a fiscal unity with the seller, special warranties are usually agreed upon with respect to the period of the fiscal unity and transactions that might have taken place within the fiscal unity.

Furthermore, the seller and buyer may have determined certain tax indemnities in the due diligence and which are described in a separate schedule.

Provided that the participation exemption rules apply, payment under an indemnification should be tax neutral for both the seller and acquiring company.

In case of an asset transaction, the tax indemnities are limited as the tax liabilities are usually left behind with the selling company.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

#### Fiscal unity

As mentioned, entering into a fiscal unity is the most important post-fiscal unity tool. Note that the fiscal unity can only be implemented when the acquiring company possesses all shares at the beginning of the book year. As per 1 July 2018, it is possible to form a fiscal unity during the book year. Provided certain conditions are met, a subsequent fiscal unity can be granted. It is important that on the first day of the new book year the shares of the subsidiary are transferred. It is also possible to create a subsequent fiscal unity with a newly incorporated parent company.

It is important with a subsequent fiscal unity with a newly incorporated parent that the purchase price of the subsidiary is irrevocably agreed upon and it is agreed upon that the shares in the subsidiary are held for the account and risk of the buyer. The shares must be transferred on the first working day after the day of incorporation of the acquiring company.

In situations where a Curaçao company is acquired by a non-resident company and the acquisition is financed with debt, setting up a new Curaçao parent can be considered, combined with debt acquisition by the new holding and forming a fiscal unity in order to set off interest payments with operational profits of the target.

Alternatively, the target may apply for a tax transparent status that may enter into force on the first day of the new book year.

Spin-offs of businesses that are not of interest to the buyer are also possible.

## 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

The tax rules that facilitate a tax neutral demerger have been introduced as of 1 January 2017. A tax-neutral demerger is possible provided the following four conditions are met:

- both the acquiring and disappearing company may not have any losses that are eligible for carry forward;
- both companies have the same system for profit determination;
- the tax claim on the assets must be secured (realised by continuing with the book value); and
- the merger must be based on sound business reasons (see share exchange before).

If the four conditions are not met, a facilitated merger or demerger can take place on request. Standard conditions are published with demands that must be met.

As in the enterprise merger, the shares acquired after a demerger cannot be sold for a period of three years. However, as in the enterprise merger, it is possible to request a relief for the prohibition to sell the shares.

In both the demerger and merger, the companies continue with the original cost-price of the assets and, contrary to an asset transaction, no tax is levied upon acquiring assets through a merger.

The merger rules of the CCC allow an inbound cross-border merger in which a foreign legal entity is the disappearing entity (provided that foreign law allows such merger) and an outbound cross-border merger when the Curaçao legal entity is the disappearing entity.

As in the share exchange, the merger rules also contain a facility in cases when the shareholders are individuals with a substantial interest.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Under the CCC it is possible to re-domicile a Curaçao company and continue its existence under foreign law provided that under foreign law such conversion is not considered a liquidation but a continuation under that country's law. Foreign law must allow such conversion.

It is also possible to convert a foreign company and continue its existence under Curaçao law.

If the articles of association of the Curaçao company incorporated before 1 March 2004 has a reference to the national ordinance on

statutory seat transfer to third countries (NOTS), than such transfer may be executed under this old ordinance. The NOTS was abolished upon the introduction of the new conversion rules in the CCC, but reinstated only for those old offshore companies that have an explicit reference to the NOTS in their articles of association.

The aforementioned ordinance contains a specific clause that the conversion is tax-neutral and may still be applied in cases when the articles of association contain a reference to the NOTS.

The tax facility rules for conversion, merger and demerger contain rules for a conversion for shareholders and the company. Tax claims can be bypassed.

With a continuation under foreign law, the Curaçao company will cease to be a tax resident of Curaçao and Curaçao taxes are due on benefits not yet taken into account.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Curaçao does not levy any withholding taxes on dividends, interest or royalties.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Curaçao does not levy any dividend withholding tax. It is therefore quite simple to extract profits as long as there are sufficient retained earnings.

In cases when the target has a large share capital or share premium reserve, it may be attractive to take a shareholders' decision to reduce the nominal value of the shares, amend the articles of association and repay capital. Under these conditions, the repayment is not considered a dividend.

In case of high share premium reserves, the shareholders can take a decision to convert the share premium in share capital followed by a decision to reduce the nominal value per shares. After the amendment of the articles of association, the company can repay capital, which is not considered a dividend payment.

Creating a hybrid debt is another possibility to extract profits from the subsidiary, especially if there is a mismatch and the debtor can deduct the interest payable.

Under hybrid financing the debt is considered equity and interest payments received qualify for the participation exemption.

In general, the Dutch Supreme Court considers a loan as a hybrid loan if the following conditions are met:

- the loan must be perpetual;
- the loan must be subordinated to all other loans;
- the interest payments are profit dependent; and
- the loan can only be recalled in case of bankruptcy or moratorium of payment or liquidation.

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Case law is diverse and the conditions under which a hybrid is available may vary from case to case.

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### **Disposals (from the seller's perspective)**

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#### **15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

A disposal of stock is generally more favourable if the participation exemption rules apply. Disposal of assets is taxed at the normal tax rate of 22 per cent unless a special regime applies, such as the economic zone regime, where a tax rate of 2 per cent applies and the assets are sold to either another company in the economic zone or a non-resident buyer.

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#### **16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Generally the disposal of stock in a Curaçao company by a non-resident company will not lead to taxes in Curaçao unless the shares are the asset of a Curaçao permanent establishment, although in such cases the Supreme Court has ruled that the permanent establishment may apply the participation exemption rules. The same goes in case the non-resident company holds shares in a Curaçao real estate company or energy company or a company that exploits natural resources.

A non-resident company will only be considered a foreign taxpayer for profit tax purposes if it directly holds real estate in Curaçao or a mortgage vested in real estate in Curaçao.

As mentioned above, individual shareholders may have a substantial interest in a company. This does not have to be a substantial interest in a Curaçao company.

The substantial interest rules are applicable when an individual, whether or not together with his or her spouse, possesses at least 5 per cent of the shares in a company. The substantial interest rules do not apply to non-residents if they have never been a resident of Curaçao.

An individual who has been a resident of Curaçao and possess 5 per cent or more of the shares in a company will be taxed under the substantial interest rules if he or she sells the shares within a period of 10 years after leaving Curaçao.

Under the Tax Arrangement Netherlands Curaçao, an individual with a substantial interest in a Curaçao company emigrating to the Netherlands will be subject to Curaçao substantial interest rules for a period of 10 years.

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#### **17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

The Curaçao profit tax contains a 're-investment reserve' under which capital gains can be reserved provided four years have passed following the year of the sale of the assets. However, the investment in the new business assets must be similar to the assets sold.

# Ecuador

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Under Ecuadorian law, there are few tax implications that may differ with respect to the way the parties can structure a transaction.

In general terms, the acquirer will not receive different treatment from a tax liability standpoint. Based on our Tax Code, the way parties can structure the acquisition of a company or business will bear the same tax liability. The Ecuadorian Tax Code stipulates that the acquirer is liable in the fiscal year in which the transaction was executed and for the two fiscal years preceding, with respect to all the taxes due by the target company or that are outstanding with regard to the business assets and liabilities. That liability is limited, however, to the value of the acquired assets and will cease within one year of the transaction as long as the acquirer complies by informing the Internal Revenue Service of the transaction.

When a new company substitutes the target company, taking over its assets and liabilities under a merger operation, the tax liability will include all taxes due by the former up to the effective date of the operation.

If the target company has a tax benefit, such as net operating loss carry-forwards, the acquirer would need to evaluate the best way to acquire the company's shares, since such benefit would not follow the assets if these are purchased and will remain with the target company. Conversely, an asset deal could be beneficial taxwise from the seller's perspective to offset future gains in such a case.

Ecuador tax law levies income tax, pursuant to specific rules. The seller's gains, in either of the cases mentioned above, will be subject to tax at the corporate level if the transaction is made through the acquisition of the entire business, meaning the acquisition of assets and liabilities, or if the transaction will be made through a transfer of shares.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In asset transactions, the purchaser will usually receive a fair market value for assets and post that value in its books for depreciation purposes. Therefore, acquiring the target company's assets, as well as acquiring the assets resulting from business spin-off transactions, will get a fair market value.

Nonetheless, in the case of merger transactions, if there is any difference between an asset's residual book value and its fair market value, the difference will not be deemed to be taxable income. Moreover, the difference cannot be depreciated in the new company resulting from the merger operation.

When the target company has revalued assets, the depreciation from the revaluation is not deductible. If a new value is assigned to fully depreciated assets, the asset cannot be depreciated again. In the

case of a sale of revalued goods, the difference between the sales price and the residual value, without considering the revaluation, will be regarded as taxable income.

Intangible assets can be amortised for tax purposes in the terms provided under the contract, for a period of not less than five and, in general, not more than 20 years. Pursuant to Ecuadorian tax regulations, goodwill cannot be depreciated.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Regarding the acquisition of shares of a local company (target company), Ecuadorian legislation ascribes the same tax treatment whether the acquirer is a company domiciled or not domiciled in Ecuador.

When a foreign company acquires an Ecuadorian company, it is advisable that the foreign company be domiciled in a country with which Ecuador has signed a double taxation agreement.

The advantage of having the acquirer domiciled abroad is that, in addition to being exempt from income withholding tax, dividends will not be subject to the capital outflow tax.

The outflow tax rate is 5 per cent of the transaction value.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Mergers and share exchanges executed abroad involving an Ecuadorian company are often used. Nonetheless, transactions concerning acquisitions of business assets and liabilities or acquisitions of stock are the most common.

Mergers and spin-offs are commonly used because these forms of company reorganisation or transformation are tax free under Ecuadorian tax legislation. Transfers of shares using these forms and made under certain conditions are tax free so long as no gains are produced.

The law establishes that gains on the direct or indirect disposal of shares and other rights representing capital are regarded as income subject to income tax. Merger or spin-off processes are excluded from this rule provided the actual earnings on the disposal of shares or other rights representing capital are the same before and after the process.

### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

Ecuadorian Law does not have tax benefits to the acquirer in issuing stock as consideration rather than cash.

**6 Transaction taxes**

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

No documentary taxes are payable on the acquisition of stock or business assets, in accordance with Ecuadorian legislation. The acquisition of stock only generates capital gains subject to income tax.

The sale of businesses in which all assets and liabilities are transferred does not generate value-added tax. If, however, business assets are sold separately, the value-added tax would apply at a rate of 12 per cent. For the transfer of ownership of fixed or immovable assets, the 1 per cent municipal property tax must be paid.

Notwithstanding the foregoing, there are other costs, such as notary, registration and other fees, applicable to this kind of transaction.

**7 Net operating losses, other tax attributes and insolvency proceedings**

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

With respect to net operating losses, pursuant to article 11 of the Tax Law, a company's losses from previous years may be offset with the taxable profits obtained within the following five tax periods, without exceeding 25 per cent of the profits obtained in a period. There is no impact when the acquisition is made through the acquisition of a company's stock. If made otherwise, however, this benefit will not follow the assets acquisition as mentioned earlier. Likewise, VAT credit and refunds on excessive tax payments are not affected by a change of control.

Ecuadorian legislation does not provide a special tax treatment, regime or rules for insolvency or bankruptcy.

**8 Interest relief**

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

In accordance with article 13 of the Internal Tax Regime Law, there are many conditions for interest payments to be deducted as a financial expense for loans obtained abroad. If the Ecuadorian acquisition company resorts to borrowing money for acquiring the target, it must obtain a loan from a foreign financial entity duly incorporated abroad or a financial entity qualified by the relevant Ecuadorian oversight entities. In these cases, interest cannot exceed the maximum reference interest rates set by the Monetary and Financial Policy and Regulation Board on the date of registration of the loan or the date of novation thereof. If these conditions are met, but the interest rate exceeds the maximum reference interest rate, the excess portion will be subject to withholding tax in order to be deductible.

In the case of interest paid abroad that does not fulfil these requirements, a withholding tax at the same rate as for the general corporate income tax will also apply regardless of the lender's residence.

Furthermore, Ecuadorian legislation includes several other provisions that limit interest deductibility for both unrelated and related parties, such as in the case of transfer pricing rules. Back-to-back loans are expressly prohibited under Ecuadorian law.

**9 Protections for acquisitions**

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

In general terms, parties are completely free to opt for any contractual warranty or fix any contractual indemnity with respect to acquisition.

From a tax perspective, including specific clauses in an SPA or APA is the most common method used by parties for their protection. The stipulations contained in those agreements provide representations and warranties in respect of any unforeseen tax liabilities arising from post-transaction tax assessment and any unanticipated due tax.

**Post-acquisition planning****10 Restructuring**

**What post-acquisition restructuring, if any, is typically carried out and why?**

Post-acquisition restructuring focuses mostly on corporate and labour issues. An amendment to the by-laws will be made so that they can be adapted to the acquirer's structure. In addition, the internal labour regulations will be amended to reflect the acquirer's labour policies, as long as such policies are consistent with the legal scope of Ecuadorian labour law.

**11 Spin-offs**

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Spin-offs can be tax neutral. In accordance with Ecuadorian law, the NOLs of the spin-off company will be transferred to each of the resulting companies in proportion to the assets and liabilities transferred to each of them.

As an additional fact, in the case of a total spin-off (ie, when the company is extinguished to form two or more companies), the Tax Code stipulates that the companies resulting from the spin-off will be jointly and severally liable for the tax obligations owed by the company being spun off, up to the date of registration of the spin-off in the Commercial Register.

Transfers of assets and liabilities made in the spin-off process are not subject to income tax.

The spin-off will not be subject to VAT.

**12 Migration of residence**

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Although the migration of residence to Ecuador of the acquisition company has been recently regulated under the Companies' Act, there are no tax regulations in this respect. Under these circumstances, the target company cannot migrate from our jurisdiction without having first terminated its operations and cancelled its tax registration number. The IRS will then have a period of six to seven years to perform assessment post cancellation and collect any outstanding tax. Companies must keep all documents for that same period.

**13 Interest and dividend payments**

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Dividends paid to non-resident shareholders, whether individuals or corporations, are tax exempt. Interest payments are subject to the tax treatment explained in the answer to question 8. Interest payments remitted abroad are subject to the 25 per cent withholding tax and would not be considered as a deductible expense if they fail to fulfil

the requirements provided under the Ecuadorian tax law, as explained above. In addition, if the beneficial owner of such interest payments is domiciled in a tax haven or low tax jurisdiction, said payment will also be subject to an additional 10 per cent withholding. There are, however, certain economic sectors that are exempt from this withholding regardless of the lender's domicile or residence.

#### 14 Tax-efficient extraction of profits

##### **What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Aside from exempting dividend payments paid to non-resident shareholders, whether corporations or individuals, Ecuador has executed several tax treaties particularly with European and Asian countries, as well as with countries in the Latin American region, which prevent double taxation. The treaties provide reduced withholding rates for interest and royalty payments. Furthermore, to attract investment in different economic sectors, the national assembly has recently enacted a law providing longer tax holidays for investment in new industries and other service activities.

#### **Disposals (from the seller's perspective)**

#### 15 Disposals

##### **How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

All these methods are commonly employed. If the transaction takes place abroad and involves a direct or indirect disposal of the stock in a local company or of the stock of its foreign holding company, the resulting capital gain in either case will be subject to income tax in Ecuador. For indirect transfers of stock, the seller must determine whether certain parameters provided under the law have been met for the gain to be subject to the tax.

If the chain of ownership shows that the actual beneficiary of a transfer or sale is an individual who is a resident in Ecuador, then, for tax purposes, it will be understood that there was a direct sale and the gains thereon will be subject to income tax at a rate of up to 10 per cent, depending on the amount involved. With respect to the assignment of other assets, the type of asset and the gain on the transfer or sale thereof would have to be considered. In any case, the gain would be included in the company's total income for tax purposes.

#### 16 Disposals of stock

##### **Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

The disposal of stock in a local company by a non-resident company is subject to income tax at a rate of up to 10 per cent when the transaction produces a gain. If, however, the non-resident company fails to pay the tax when disposing of its stock, the Ecuadorian tax administration will hold the local company, the shares of which are being disposed of, liable and collect the tax from it to secure payment.

In general, tax legislation stipulates that gains on the direct or indirect sale of shares or other rights representing capital or different rights concerning exploration, exploitation, concession or the like by local companies or permanent establishments in Ecuador, are subject to income tax. Therefore, no special rules apply to real property, energy and natural resource companies.

There are specific rules, however, when the transaction is performed through the Stock Exchange.

#### 17 Avoiding and deferring tax

##### **If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Our legislation does not provide specific methods for deferring the payment of the tax applicable to the gain on the disposal of shares. Likewise, gains on the disposal of business assets are also taxable and Ecuadorian law does not provide any tax deferral method. Nonetheless, it should be noted that the Ecuadorian tax law does not levy an income tax on gains from the occasional disposal of immovable property.



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# Germany

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

German tax law distinguishes between two fundamentally different cases of enterprise acquisitions.

The first (case 1) is the acquisition of stock in a corporation (share deal). The second (case 2) is the acquisition of the assets and liabilities of a corporation or other enterprise, the acquisition of a whole enterprise run by a single natural person and the acquisition of interests in a partnership. The asset deal rules also apply if only a part of a business shall be acquired. In addition, German corporate and tax law provides rules where, under certain conditions, parts of the business could be split off on a book-value basis into a new or existing corporate entity.

Corporations are subject to German income tax and trade tax. Only a corporation possesses a fiscal identity separate from its shareholders. Therefore, in case 1, the book values of all the single assets and liabilities in the accounts of the target company remain unchanged for income tax and trade tax purposes. The purchase price paid by the buyer is allocated to the buyer's acquisition cost of the shares in the corporation as such. Neither the buyer nor the target may facilitate the purchase price for tax-effective depreciations, apart from rare cases where the value of the company is permanently decreasing because of permanent significant losses. In that scenario a current-value depreciation may be applicable. The purchase price only becomes tax-effective for the seller if it resells the target. If the seller is a corporation subject to German corporate income tax, only 5 per cent of the capital gains from the transaction are taxed, otherwise capital gains may be 40 per cent tax-free.

The purchase of assets and liabilities of a business, no matter whether it is run by a single natural person or any other entity, for tax purposes is treated as if the buyer had bought all the single assets separately. The liabilities allocated to the target are treated as a (negative) part of the purchase price. Therefore, in case 2, the net purchase price paid by the buyer is equally allocated to the single assets of the target company up to the market value of the assets. If the purchase price exceeds the market value of all assets, the exceeding amount can be activated as goodwill. As far as the assets have a limited useful life, the buyer benefits from depreciation for purposes of its personal income taxation. In addition, the acquiring entity can deduct the depreciation of the assets from its trade tax base.

Partnerships are treated as being transparent for German income tax purposes. The acquisition of partnership interests for tax purposes is treated as if the buyer had bought, proportionately, all the single assets of the partnership.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Goodwill and other intangibles may only be added to the tax balance sheet of a company if they have been purchased (section 5(II) of the Income Tax Act (EStG)), the only exception being a merger. Because depreciation of an item is inconceivable without its prior entry into the balance sheet, such assets need to be traded at least once before they can be used for tax depreciation. The buyer is advised to include in the purchase agreement a specific price for each intangible asset to avoid later dispute over their value.

Assuming that goodwill and other intangibles are already included in the target's balance sheet and thus responsible for a part of the share price, a depreciation of their market value can indeed be used for tax purposes in a share deal, but only if that depreciation leads to a traceable loss in the share price. Buyers are advised that a share deal does not provide in itself an opportunity to add intangibles to the balance sheet for later depreciation. As for type 2 deals, they are generally open to tax depreciation, which becomes effective on the level of the buyer (see above). Tangible assets are treated no differently, as long as they have a limited useful life. Goodwill, for instance, is considered by the Income Tax Act to have a life span of 15 years (section 7(I)(3) EStG).

More generally, a step-up in basis in the business assets of the target company is only possible under German tax law in an asset deal. A step-up in basis is realised if the purchase price plus the liabilities taken over is higher than the book values of the assets together. The excess purchase price is allocated to all the assets of the target proportionately to their market value. If there is still a mismatch between the purchase price and the accumulated market values of the assets, the difference is treated as acquired goodwill.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

For the consequences of a purchase described in questions 1 and 2, it makes no difference in principle whether the acquisition company is established in Germany or abroad, as long as the target has a permanent establishment in Germany.

It may be preferable, however, to have a German acquisition company, with respect to the tax treatment, in the post-acquisition time. The acquisition company and the target company may only form a tax group if the acquisition company has its residence or place of management in Germany. Forming a tax group enables the two companies to offset the losses of one company (eg, the interest expenses of the acquisition company) against the profits of the other company (eg, the target company). Nevertheless, it is possible that a German permanent establishment (PE) of a foreign corporation may form a tax group with a German subsidiary, but only if the shares are held in this PE and limited to the profits and losses related to this PE.

A German acquisition company is also required if restructuring measures are planned after the acquisition. For example, mergers can



be structured tax-neutrally, but this is only the case if the merger does not lead to a restriction of the German entitlement to levy income taxes on the assets transferred during the merger. The sole restriction of the German entitlement to levy trade tax does not have any adverse effects; this is mainly due to its design as a municipality tax.

If only a part of the shares in a target corporation is to be acquired, it can also be advantageous to structure the purchase with a German acquisition vehicle in order to avoid adverse withholding tax issues with respect to future dividend payments. For dividends paid by a German corporation to a foreign shareholder, the EU Parent-Subsidiary Directive and many double taxation agreements stipulate minimum shareholding quotas in order to avoid or reduce withholding taxes. This problem can be avoided by using a German acquisition vehicle, since a German corporation as a shareholder can generally receive almost (95 per cent) tax-free dividends and demand a refund of the withholding taxes.

#### 4 Company mergers and share exchanges

##### **Are company mergers or share exchanges common forms of acquisition?**

Company mergers and share exchanges are frequently chosen forms of acquisition in Germany, as the Reorganisation Tax Act (UmwStG) generally provides for the parties having the choice of whether they want to realise a step-up in basis in an amount to be determined flexibly up to any amount up to fair market value of the assets or if the buyer takes a carry-over basis in the assets acquired. However, the UmwStG generally only applies if both companies have been founded under the laws of a member state of the EU or the European Economic Area (EEA) and have their residence and place of business in one of these states. In addition, it is generally required that the transferred assets or corporation shares remain subject to German taxation after the transaction in order to have the option to value the assets or corporation shares at a value lower than the market value. Therefore, the receiving company will need to have its residency, place of management or at least a branch in Germany. However, a step-up in the single assets owned by the target company is only possible in a company merger or demerger. In a share exchange, the assets of the target have to be valued on a carry-over basis. The right to opt for a step-up refers only to the shares of the acquired company. If no choice is made in the context of the first tax return after the merger, a step-up in basis is the rule.

#### 5 Tax benefits in issuing stock

##### **Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

From the seller's perspective, issuing its own shares as consideration for shares in the target can be advantageous, since the UmwStG allows for the option to take a carry-over basis in the shares acquired instead of a realisation of the hidden reserves in the target shares. However, choosing this option would be disadvantageous for the buyer, as the buyer would then have less acquisition cost for the target shares acquired and would therefore realise a higher taxable profit in a future sale of the shares. This effect may be of less importance because the profit from the later sale of the shares would be 95 per cent exempt from tax. If the option is not exercised, issuing stock as consideration is not treated differently from paying cash.

#### 6 Transaction taxes

##### **Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

There are no documentary taxes in Germany. The sale of shares in a corporation or partnership is generally VAT exempt, but the seller is entitled to opt for VAT. This can be sensible under certain circumstances, for example, if the seller has received certain services with respect to the shares in the past, which have been burdened with input VAT. There are no other transaction taxes in Germany that apply to company sales. Nevertheless, one has to bear in mind that fees for notarisation and registration to the commercial register and the land register have to be paid. These are statutory fees according to a fixed schedule depending on the value (purchase price) of the matter.

However, special attention must be paid to real estate transfer tax if the target owns real estate that has a great value. The acquisition of at least 95 per cent of the shares in a corporation or partnership that owns a piece of land by one buyer or related parties is treated as if the piece of land itself was sold. In this case, real estate transfer tax of 3.5 to 6.5 per cent of the value of the piece of land becomes due (section 1(II)(a), III and III(a) of the Real Estate Transfer Tax Act (GrEStG)). The rates depend on the German federal state where the real estate is located. In the past this result could be avoided by 'RETT-blocker structures'. If the target company is of the non-incorporated type, the tax can be avoided by leaving at least 5.1 per cent of its shares in the hands of the original owners. After a waiting period of five years, the remaining stake can be transferred to the buyer without any negative fiscal consequences. This solution is not an option if the target company is a corporation or a partnership. To avoid the real estate transfer tax in this latter case, a permanent division of the target's shares into two separate entities is necessary and those entities must not belong to the same group. Section 6(a) GrEStG exempts an otherwise taxable transfer within the same group, but this exception only works when the target has belonged to the buyer for at least five years before the transfer takes place. New legislation came into force in 2013. The new rule looks not at the nominal percentage of 95 per cent but takes an 'economic view' and takes into account all direct or indirect participations of the buyer in the respective company. Nevertheless the new rule does not apply to reorganisations within a group of companies. A proposal to have even more restrictive rules against RETT blocker structures is in the legislation. Most probably the threshold of 95 per cent will go up to 90 per cent and the minimum holding period will go up to 10 years.

#### 7 Net operating losses, other tax attributes and insolvency proceedings

##### **Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Section 10(d) of the EStG stipulates a minimum taxation that works as follows: if a net annual loss arises, it may be carried back to the previous fiscal year up to an amount of €1 million. If the loss is still not neutralised after that, it is carried forward into future fiscal years. Once the company makes a surplus, the minimum taxation rule prevents it from instantly setting off all accumulated losses against new surpluses. Instead, usage of carry-forward losses is capped at 60 per cent for each fiscal year. Only the first million of losses can be offset without limitations. For example, a company with a surplus of €10 million in 2016 and an equal amount of carry-forward losses has a taxable income of €3.6 million, which may be called the minimum taxable income. The remaining losses are carried on until they are used up. Forming a tax group can reduce the impact of the minimum taxation clause by eliminating losses within the group immediately instead of carrying them forward.

While the aforementioned limitations only defer the usage of carry-forward losses, additional rules pertaining to a change of control in share deals affect the very preservation of such losses. Acquiring a company's shares eliminates carry-forward losses either proportionately (25.1 per cent to 50 per cent of shares acquired; anything less has no effect) or entirely (50.1 per cent and above) for purposes of corporate income and trade tax (section 8(c)(I) of the Corporate Income Tax Act (KStG) and section 10(a)(X) of the Trade Tax Act (GewStG)). Shares bought by a group of acquirers with common interests are added. The loss-elimination clause covers not only direct transfers of shares, but any similar type of transaction, leaving almost no room for a preservation of losses. However, the elimination does not kick in if the target and acquiring corporation entirely belong to the same group or if the target's carry-forward losses exceed its existing hidden reserves.

Losses from one business year can be carried back to the previous year (restricted to amounts of up to € 1,000,000). Remaining losses are then carried forward, up to an amount of € 1,000,000 with no limitations, after that at a rate of 60 per cent of the remaining losses. The rest may be used in future years. The utilisation of losses is permitted in company groups under certain requirements. Existing losses carried

forward are cancelled according to the rules in the Corporation Tax Act:

- in full if more than 50 per cent of the shares of a corporation are transferred within a period of five years; or
- proportionately to the amount of shares transferred if more than 25 per cent but less than 50 per cent of the shares in a corporation are transferred within a period of five years.

A special rule had been introduced into § 8c KStG in order to facilitate the preservation of losses during the takeover of a crisis-stricken company. This rule has been relaxed by new legislation in § 8d KStG concerning preservation of losses carried forward in cases of share transfers within groups of companies or if the business is continued without major changes.

Existing losses can be preserved in the course of a share transfer aimed at avoiding a company's bankruptcy, if the business of the company is continued and either one of the following prerequisites is met (§ 8c KStG):

- a works council agreement on the restructuring scheme including provisions for the preservation of a certain number of jobs;
- in the five years following the share transfer, the company pays at least 400 per cent of the wages it has paid in the five years preceding the transfer; or
- the company's equity is raised by at least 25 per cent of the company's assets.

§ 8d KStG concerns the preservation of losses in a company in case of a change in ownership and the losses cannot be used otherwise. In cases where a new shareholder or a change in the shareholders is necessary for the continuity of the business and to receive proper financing, the losses carried forward may be preserved if the business of the company will be continued without major changes as far as the services or products, customers and suppliers, the markets served and the qualification of employees are concerned. Further restrictions apply as far as the business is concerned. The losses can be carried forward until they are fully used and no adverse event like the closing of the business or the implementation of new business activities occurs.

If the company realises profits in the course of a reorganisation due to a cancellation of debt, the tax authorities may grant a deferral and later a waiver of the taxes on these profits, but only after all net operating losses and losses carried forward have been used up to offset against these profits. That was an instruction of the Federal Ministry of Finance ('restructuring decree'). With its judgment of 28 November 2016, the German Supreme Tax Court has decided that the restructuring decree is not compatible with the principle of legality of administration. The court dismissed the application of the restructuring decree and pointed out that the taxation of restructuring gains is only subject to the German tax law provisions. The conditions for a tax remission on equitable grounds, which are laid down in the restructuring decree, do not describe any case of objective unfairness within the meaning of articles 163 and 227 of the German Fiscal Code. In response to these judgments, the rules of the restructuring decree were introduced in a new section 3a in the German Income Tax Act. However, it will only enter into force on the day on which the European Commission decides that the new section 3a does not constitute a state aid within the meaning of article 107(I) of the Treaty on the Functioning of the European Union, or it is a state aid but compatible with the common market.

Tax credits (ie, withholding tax credits that have been accumulated before the acquisition) stay with the corporation even after a change of control. They are subject to the regular limitation periods.

In asset deals the tax losses accumulated by the target before the change of control can generally not be used by the acquirer in the future, because they always stay with the former shareholder or owner of the business.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

German tax law has extremely strict limitations to the deductibility of interest payments by a company belonging to a group (the 'interest-barrier rule' (section 8(a) KStG and section 4(h) EStG)); it is one of the greatest obstacles to deal with in large transactions in Germany.

If a group company has outgoing interest payments that exceed its incoming interest earnings by €3 million, only 30 per cent of the profits (earnings before interest, taxes, depreciation and amortisation) can be offset against interest payments. In contrast to the minimum taxation rule discussed in question 7, the interest-barrier rule spares no base amount from this restriction, so it is all or nothing in this case. Additionally, profits that have not been offset against interest expenses can be carried forward for five years at the most, but they may be lost in a case of change of control. If they remain unused until then, they become definite profits. Unused excess interest, on the other hand, can theoretically be carried forward indefinitely.

A group company remains unaffected by the interest-barrier rule if its equity-to-assets ratio is higher or equal to the ratio of the corporate group as a whole.

This rule does not only apply if the lender is foreign, a related party, or both, but applies to interest payments to any kind of lender. To make matters worse, the exceptions provided for companies not belonging to a group or equipped with a good equity-to-asset ratio are largely overridden by special stipulations in section 8(a)(II) and (III) KStG if more than 10 per cent of the excess interest payments go to a person that owns at least one-quarter of a corporation, or to someone related to or controlling that person (section 8(a)(II) and (III) KStG).

Withholding taxes on interest payments are usually not an issue, as the obligation to withhold taxes on interest payments applies only if the debtor is a bank or financial institution or the loan has been registered in a public debt register. However, for related-party debt, additional restrictions apply, as the interest payments are only deductible if assessed at arm's length. Otherwise, they are treated as hidden profit distributions and trigger withholding tax. If the acquirer is a foreign company, any withholding taxes can be a definite tax burden.

Debt pushdown cannot be achieved by a simple assumption of debt, as this can be treated as a hidden profit distribution from the target to the acquirer. In this case, withholding taxes become due. Under certain circumstances these consequences may be avoided by executing the debt pushdown as a reorganisation under the Reorganisation Tax Act, but this is more complicated and expensive than a simple assumption of debt.

There are no restrictions for debt pushdown other than those mentioned above. Should the acquirer be unwilling to undergo the effort of a reorganisation, he or she can at least realise a partial debt pushdown to take full advantage of the €3 million interest excess allowance per company and year.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Protections for acquisitions are found in most asset or share-purchase agreements concluded in Germany. Usually the seller guarantees that all tax obligations have been fulfilled in the past and that the tax liabilities as presented in the annual accounts and the documents provided during the due diligence have given the purchaser the complete and correct picture of the situation. The seller commits him or herself to pay any taxes assessed after the transaction by the tax authorities, as far as the cause of these taxes is to be found in the time before the closing of the transaction.

Payments under a warranty claim reduce the profit from the sale on the side of the seller. If the payment is made to the purchaser it reduces the acquisition price and at the same time, the value of the target. A tax would be triggered only in a future sale. If the payment is made into the target company it would be treated as extraordinary income and would be subject to the normal tax in the respective business year. No withholding tax would become due.

## Post-acquisition planning

### 10 Restructuring

#### What post-acquisition restructuring, if any, is typically carried out and why?

A typical restructuring measure after the acquisition of a company is a merger of the acquisition vehicle into the target in order to realise debt pushdown without the adverse tax consequences a simple assumption of debt would have (see question 8). Other than in upstream mergers the existing losses carried forward are not lost in the absorbing company.

Another frequent post-acquisition measure is a change of legal form in order to change the tax treatment of the profits distributed by the target to the buyer under the relevant double taxation agreement. For example, a transformation of a partnership into a corporation might be sensible if the respective double taxation agreement provides for a withholding tax relief for dividends, while a transformation the other way around can be advantageous if there is no withholding tax relief in the double taxation agreement.

An upstream merger of the target into the acquisition vehicle might help avoid the taxation of 5 per cent of the profit distributions of the target to the acquisition vehicle pursuant to section 8(b) KStG.

If the target owns real estate that is rented to other parties, it is advisable to transfer the real estate from the target into a separate company. Rental income is free of trade tax (sections 9(1) and 2 to 6 GewStG), but only for companies that exclusively rent out real estate and do not participate in any other business activities.

Another post-acquisition restructuring is the formation of a tax group between the target and the acquisition vehicle for corporate tax and trade tax. This can usually be achieved by signing a profit-and-loss-sharing agreement with a minimum term of five years but may be achieved retroactively if the profit-and-loss-sharing agreement is properly registered in the commercial register until the end of the respective year. VAT tax groups arise automatically if the subsidiary is sufficiently integrated into the parent company (section 2(II)(2) Value Added Tax Act).

### 11 Spin-offs

#### Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

A tax-neutral spin-off can generally be achieved under the UmwStG, but a sale of more than 20 per cent of the shares in the spun-off business within the following five years will lead to a retroactive taxation of the hidden reserves (section 15(II)(4) UmwStG).

The net operating losses cannot be transferred in their entirety; rather they follow the spin-off in proportion to the assets received from the transferring company (section 15(III) UmwStG).

In a spin-off scenario real estate transfer tax of 3.5 to 6.5 per cent (depending on the federal state in which the property is located) becomes due on the value of real estate transferred in the course of the spin-off. Spin-offs taking place within a group of companies may be exempt from the real estate transfer tax if 95 per cent of the shares in the spin-off are held for at least five years by the transferring company or another member of the group (section 6(a) GrEStG).

## Update and trends

Owing to a decision of the Federal Constitutional Court the law about calculation of the basis for the land tax has to be revised by the end of 2019. This will lead to a significant increase in the land tax at least on bigger properties.

Until now, investment funds have widely been exempt from taxation and only individual investors were subject to tax, even if gains were not distributed. From 2018, the taxation of investment funds was fundamentally reformed. Gains will now be taxed at the level of the fund, not at the level of the investors. All funds are taxed according to the same scheme: on the basis of an annual lump sum. At the fund level, investment funds are partially subject to corporate tax with their domestic dividends, domestic rents and profits from the sale of domestic real estate. The tax rate is 15 per cent each, which means that the solidarity surcharge is already included with regard to domestic dividends and the solidarity surcharge is still in addition. At the investor level, all distributions and profits from the sale of the shares are, in principle, taxable. The new legislation will change this in respect of funds that are not special funds. The key point of the new legislation is that gains will be taxed at the level of the fund, not at the level of the investors. The aim is to tax national and foreign public investment funds equally. To avoid double taxation, certain distributions will be partially exempt from tax. The Federal Ministry of Finance has issued several guidance letters on the application.

### 12 Migration of residence

#### Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

If a corporation's residence is migrated from Germany to a state that is not a member of the EU or EEA, the corporation is treated as if it were liquidated (section (12)(III)(1) KStG), pursuant to the market value, and the shareholders are taxed on this basis.

If a partnership's residence is moved to any foreign state or a corporation's residence is moved to an EU or EEA state, this will not lead to adverse tax consequences as long as no assets are moved away from Germany. Several recent court decisions suggest that, even when moved away, their hidden reserves remain taxable under section 49 EStG, but this judicial twist may yet be overturned by new legislation.

### 13 Interest and dividend payments

#### Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Interest payments are only subject to withholding taxes if either the debtor is a bank or other financial institution or the debt has been registered in a public register (section 43(I)(1)(7) EStG). This restriction applies irrespective of the residency of the lender. If the lender is a foreign entity, which is not subject to unrestricted tax liability, the interest payments are – in addition – only subject to withholding taxes if the debt is collateralised by German real estate (section 49(I)(5)(c)(aa) EStG).

Dividends paid by German corporations are generally subject to German withholding taxes under national German law (section 43(I)(1) EStG).

The withholding tax rate for interest and dividends is 25 per cent (section 43(a)(I)(1)(1) EStG). The tax may partly be reimbursed on the grounds of a double tax treaty. If a particular certificate can be obtained before the dividend is paid, no withholding tax will be charged in the first place (section 50(d)(II) EStG).

Until February 2013, under the old German tax regime, dividends to shareholders holding over 10 per cent were not subject to withholding tax if the shareholder was resident within the EU or were only subject to a reduced withholding tax under the respective tax treaty if the shareholder was resident in a country outside the EU. Whereas for German shareholders with participation under 10 per cent there was basically no withholding tax burden, shareholders in other member states were left with the definite withholding tax burden of 15 per cent on dividends received. With the Act for the implementation of the decision of the European Court of Justice of 20 October 2011 in case



C-284/09 German legislation followed the order of the court to review the withholding tax regime for minority shareholders. The new law has been in force since 1 March 2013. The main details of the new law are as follows:

- All dividends paid after 28 February 2013 to shareholders with a shareholding of up to 10 per cent are subject to withholding tax, regardless of the residency of the shareholder, whereas capital gains from the alienation of shares remain exempt from tax for domestic shareholders.
- For all dividends paid to shareholders before 1 March 2013 the new section 32(5) of the German Corporate Tax Act entitles foreign entities to reclaim withholding tax that has been paid to the German tax administration under the old regime.
- There is a complex list of conditions with which foreign shareholders have to comply and evidence to be provided if they want to successfully reclaim the withholding tax, and the new law also contains rules under which investment funds under the German Investment Tax Act can benefit for the past and the future. According to these provisions, foreign investment funds that are exempt from tax in their country of residence are not entitled to a refund of withholding tax.
- To solve pending disputes about the competent authority for the reclaiming process, a new rule has been implemented to centralise the administration process at the Federal Central Tax Office.

Dividends can only be tax-free if the respective amount has been subject to tax paid at the subsidiary level and further provided that the shareholding exceeds 10 per cent.

#### 14 Tax-efficient extraction of profits

##### What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Because dividend payments are not tax-deductible on the corporation level, but interest and royalty payments are, it is generally more efficient to pay royalties and interest rather than dividends, as long as the relevant double taxation agreement between Germany as the state of residency of the target and the state of residency of the acquirer allocates the right to levy taxes on interest or royalty income to the state of residency of the party receiving the payments. However, the acquirer has to meet certain 'substance' requirements in order to avoid the application of a special German anti-avoidance rule (section 50(d) (III) EStG, anti-treaty-shopping rule), and the royalties or interest rates have to be negotiated at arm's length to avoid the assumption of hidden profit distributions by the tax authorities.

Section 50(d)(III) has recently been revised after its precursor was deemed too harsh by the European Commission. The latest version denies a foreign company the reimbursement of withholding taxes to the extent that its shares are held by anyone who would not be entitled to a reimbursement himself or herself and the company's income does not stem from its own economic activity. However, the legislator accepts a structuring that shifts dividends out of Germany as long as

both a good non-fiscal reason can be shown and sufficient business operation facilities exist to participate in the market.

In addition, a new licence limitation rule has been implemented to be applied for expenses arising from 2018. Licence payments are only limited deductible, § 4j EStG. The new section restricts the deduction of royalties and similar cross-border payments made to related parties if, in the other country, the payments are (i) subject to a preferential tax regime, such as an IP Box regime, and the rules in the other country are not compliant with the OECD nexus approach presented in its BEPS Report on Action Item 5, and (ii) subject to an effective tax rate of less than 25 per cent. A safe harbour exists for royalty payments to a company that carries on substantial research and development activities.

If the law applies, the percentage of the payment that will be non-deductible is calculated by making reference to the percentage shortfall between the effective rate and 25 per cent. Stated mathematically, the formula is  $(25 \text{ per cent} - \text{effective tax rate}) \div 25 \text{ per cent}$ . For instance, if the effective foreign preferential tax rate is 10 per cent, German law would regard 60 per cent of all royalty payments as nondeductible. Because 10 per cent amounts to 40 per cent of 25 per cent, the shortfall between the effective rate and 25 per cent is 15 per cent – which is 60 per cent of 25 per cent.

This new legislation also captures indirect licence payments and will apply irrespective of any tax treaties (ie, treaty override).

#### Disposals (from the seller's perspective)

##### 15 Disposals

##### How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

In German tax law, a choice between share or asset deal only exists when the sold company is a corporation (see question 1). In all other cases, the type of deal is predetermined by the nature of the target. It must be remembered that this statement is true only in the area of tax law and does not extend to trade law, for example. Also, in restructuring matters the UmwStG strives to put all kinds of transformations on a par.

A disposal of the business assets of a German company as well as a sale of the shares in a partnership (type 2 deals as described in question 1) will generally lead to a full taxation of the difference between the book values of the assets and the purchase price received. In a sale of the shares in a German corporation by another corporation, only 5 per cent of the profits are subject to tax in Germany, so with a corporate income tax level of 15 per cent, the effective tax rate is less than 1 per cent. Germany does not levy taxes if a foreign holding company sells its assets in a German unincorporated company, provided that the holding company's shareholders are also resident abroad. The transaction will be taxed only in the state of residence of the holding company, therefore when determining the seat of the holding company the seller should heed the advantages of a low-tax jurisdiction.

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**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

As explained above, the disposal of stock in a local company by a non-resident company is generally subject to German tax. There are no special rules for the disposal of stock in energy and natural resource companies, but for real property companies the real estate transfer tax issues described in question 6 must be contemplated. Another problem with respect to the disposal of stock in a real property company is that the trade tax exemption described above (section 9(1)(2-6) GewStG; question 10) may become inapplicable for the future if the sale of the real estate is treated as a trading business.

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**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Because the disposal of shares in a corporation is subject only to a very low effective tax burden if both parties of the deal are corporations, a restructuring of the holding may be desirable before a sale. It is possible to transfer the shares into a corporation's property in a tax-neutral way under the Reorganisation Tax Act, but a waiting period of seven years until the disposal must be adhered to in order to avoid a retroactive taxation of the reorganisation (section 22(I)(1) UmwStG). Upon disposal of German real estate that belonged to the company's assets for at least six years, the hidden reserves may be transferred to a new asset, if the substitute asset is acquired within four years (section 6(b) EStG).



# India

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The key differences between an acquisition of stock in a company and the acquisition of business assets and liabilities are as follows.

- In the case of acquisition of stock, the consideration paid by the buyer becomes the cost of acquisition of the stock for the purpose of calculation of capital gains on transfer of stock in the future. However, there is no step-up in the cost basis of the assets of the company whose stock is being acquired. On the other hand, subject to certain conditions, in the case of an acquisition of business assets and liabilities, the buyer can achieve a step-up in the cost basis of the assets, thereby enhancing the amortisation base of assets, including for goodwill and intangibles (discussed in detail later).
- Most tax holidays available to an Indian company would continue to be available despite an acquisition of stock (partial or complete) in such a company. In the case of an acquisition of specific business assets and liabilities, the benefit of the tax holiday for the unexpired period is not available to the buyer. In cases where the business is acquired as a whole, while there is a possibility of the tax holidays being available to the buyer, the position is less secure as compared to an acquisition of stock.
- In the case of acquisition of stock in a private company (whose shares are not traded on the stock exchange), the tax losses of the company (other than unabsorbed depreciation) would not be permitted to be carried forward and set off if the acquisition is of shares in a company carrying more than 49 per cent voting power. This limit does not apply to a company whose shares are traded on the stock exchange and in certain other scenarios such as change in shareholding of an Indian company as a result of amalgamation or demerger of its foreign parent company, provided 51 per cent of the shareholders of the amalgamating or demerged foreign company continue as shareholders of the resulting company. Amendment in 2017 provided an exception to eligible start-ups for carry forward and set-off of losses wherein all shareholders having shares with voting power continue to hold such shares in the year of set-off and such loss should have been incurred during the period of seven years from the incorporation of such a company. Amendment in 2018 provided that in the case of a company covered under the resolution plan of the Insolvency and Bankruptcy Code 2016, restrictions pertaining to a change in shareholding do not apply for the carry-forward and set-off losses. In the case of an acquisition of business assets and liabilities, tax losses are not available to the buyer unless the acquisition is approved by the court and satisfies prescribed conditions.
- In the case of acquisition of stock in a company, prepaid taxes and other tax credits (such as indirect tax credits including goods and services tax (GST)) would continue to be available. Under GST Rules 2017, on application, such prepaid taxes credits can ordinarily be transferred to the buyer upon an acquisition of business assets and liabilities. Further, the buyer would need to withhold taxes prior to making payment to the seller for the acquisition of

the stock if the seller is a non-resident and if protection under a tax treaty is not available to the seller for such income. This requirement does not arise in the case of an acquisition of stock or acquisition of the business assets and liabilities if the seller is an Indian resident. However, this requirement would apply where the business assets and liabilities are sold by the Indian branch or liaison office of a non-resident seller.

- Capital gains on the sale of stock are treated as long term if the stock (shares) is listed and held for more than 12 months prior to the sale. For unlisted stock, however, the gains on transfer will be considered as long-term if the same has been held for more than 24 months prior to the sale. In the case of a sale of a business (assets and liabilities), the capital gains will be treated as long term only if the business has been carried on for more than 36 months. Similarly, in the case of sale of stock, the consideration is received directly by the shareholders, whereas in a sale of business assets and liabilities, the consideration is first received by the company and then if distributed to the shareholders, results in two levels of tax. These are capital gains tax in the hands of seller company and subsequently dividend distribution tax (DDT) in the hands of shareholders at the time of profit or dividend distribution. Although these are seller issues, they could impact the pricing of the deal from a buyer's perspective.
- Acquisition of business assets and liabilities may require a no-objection certificate from the revenue authorities to ensure that the transfer is not treated as void owing to any tax demand arising from pending proceedings against the seller as on the date of transfer. A transfer is not treated as void where it is for adequate consideration. A no-objection certificate could also be required for sale of stock and is now increasingly being insisted upon by the buyer to avoid withholding tax obligations, particularly where the stock is of an offshore company with underlying Indian assets. Guidelines have been issued for streamlining the procedure for the issue of no-objection certificates (by the revenue authorities) laying specific timelines to respond to the applicant. If the no-objection certificate is either not issued by the revenue authorities or cannot be obtained owing to lack of time, the buyer could seek an indemnity from the seller pertaining to potential loss that may arise (to the buyer) for the transaction being treated as void (which is typically agreed between the parties to be an amount equal to the sale consideration paid by the buyer) or may negotiate with the seller to seek tax insurance for the above.
- In the case of an acquisition of shares at a price less than the fair market value (FMV) of such shares, the difference between such FMV and the consideration paid will be taxable in the hands of the recipient of the shares as ordinary income. The law was amended in 2017 to cover all categories of taxpayers (companies under the extant law) for transfer of shares of unlisted companies at value other than FMV. FMV for this purpose is defined as the net asset value of the company whose shares are being transferred, to be determined on the basis of book values of its assets and liabilities. However, certain tax neutral transfers fall outside the purview of the above provisions. The sale consideration on sale of unquoted shares is deemed to be at FMV in the hands of seller for the purposes of computing capital gains tax. Accordingly, in the case of unlisted shares, the difference between FMV and actual sale

consideration shall be taxable in the hands of both buyer and seller. This will not be applicable in the case of an acquisition of business assets and liabilities by a company.

## 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

A step-up in the cost basis of the business assets is only possible in the case of acquisition of the business assets of the target company on a going concern basis. The step-up would have to be justified by an independent valuation report. There are specific anti-abuse provisions, under which the step-up could be denied if the only purpose of the acquisition is to achieve a tax advantage.

The excess of the consideration over the fair value of the assets is recognised as goodwill or intangibles in the books of the buyer. Intangibles (such as trademarks, patents, brand names, etc) are clearly specified to be depreciable assets under the law. The question of depreciation on goodwill has been a subject matter of litigation in India and there have been some rulings where depreciation has been allowed if the amount representing goodwill was actually on account of acquisition of certain intangibles such as customer lists, business rights, etc. The Indian Supreme Court has subsequently ruled that even goodwill simpliciter (ie, goodwill arising in case of an amalgamation as the difference between the amount paid and the cost of the net assets) is eligible for tax depreciation. The Supreme Court held that goodwill is a capital right that increases the market worth of the transferee and, therefore, satisfies the test of being an intangible asset, thereby being entitled to tax depreciation. However, even following this Supreme Court ruling, litigation cannot be ruled out in certain circumstances.

In the case of acquisition of specific business assets, the consideration paid by the buyer for each asset becomes the cost of acquisition for the respective asset.

In the case of acquisition of stock, the consideration paid becomes the cost of acquisition of the stock for the buyer. Accordingly, there is no step-up in the cost basis of the assets of the target company.

## 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

An acquisition of business assets and liabilities in India would have to be undertaken by a company incorporated in India, since a foreign company cannot directly own assets and carry on a business in India, except through a branch office, a project office, liaison office or a wholly owned subsidiary in certain cases, subject to prescribed restrictions.

Where stock in a company is being acquired, it may be preferable for the acquisition company to be established outside India.

This is because an Indian company is subject to corporate tax at the rate of 30 per cent (plus applicable surcharge and cess). In addition, the distribution of dividends is subject to dividend distribution tax (DDT) at the rate of 17.65 per cent (plus applicable surcharge and cess) in the hands of the company. Also, dividend paid and the DDT thereon is not tax-deductible. The gains arising on sale of shares in an Indian company triggers capital gains tax implications in India. Further, India does not permit consolidation of profits or losses for tax purposes for the group companies.

Thus, in the case of an Indian acquisition company, repatriation of profits from the target company by way of distribution of dividends could be subject to two levels of DDT (ie, first, when the target company distributes dividends to the Indian acquisition company, and, second, when the Indian acquisition company distributes dividends to its foreign parent). This dual impact is, however, relaxed in cases where the Indian acquisition company holds more than 50 per cent of the equity share capital of the target company. In such a case, the dividends distributed by the target company on which the target company has paid DDT are allowed as a deduction in the hands of the Indian acquisition company, while computing its DDT liability in the same financial year. Upon the sale of stock of the target company by an Indian acquisition

company, there would be two levels of tax – first, capital gains tax on the sale of shares, and, second, DDT on the distribution of such gains as dividends. In addition, the distribution of dividends is subject to Indian corporate laws, which permit dividends only to be paid out of profits and free reserves.

On the other hand, if the acquirer company is incorporated outside India, there would be one level of tax in India, in the case of distribution of profits by the target company in the form of dividends. Further, in the case of sale of the shares in the target company, one level of capital gains tax would be triggered in India. The capital gains tax incidence could be mitigated if the acquisition was made from jurisdictions such as Cyprus, Mauritius, the Netherlands and Singapore, by relying on the favourable tax treaties that India has with these countries, subject to satisfaction of the Limitation of Benefit (LOB) test and GAAR Regulations, discussed later. The substance test will vary from treaty to treaty and further upon the terms of the covered tax agreements (CTAs) under multilateral instruments (MLI). There has been significant debate in India on whether the benefits granted under the tax treaties are being abused by offshore companies resorting to treaty shopping, and the government has been engaging in renegotiation of tax treaties with some countries. Tax treaties with Singapore, Cyprus and Mauritius have been negotiated and revised, as discussed later. A tax treaty with the Netherlands is under negotiation. While having a tax residency certificate (TRC) (disclosing prescribed particulars either in the TRC itself or in a separate prescribed form) from the revenue authorities of the home country is the basic and most essential requirement for claiming a tax treaty benefit, the revenue authorities are also laying increased emphasis on the substance in the offshore holding companies set up in jurisdictions with favourable tax treaties.

The India-Mauritius tax treaty was amended in May 2016 to introduce a source-based taxation of the capital gains earned by a Mauritian resident on the transfer of shares in an Indian company. Pursuant to this amendment, capital gains arising from the sale of shares of Indian companies that are acquired and transferred between 1 April 2017 and 31 March 2019 are to be taxed at 50 per cent of the domestic tax rate (subject to satisfaction of certain limitation of benefits conditions), while capital gains arising on the transfer of shares of Indian companies acquired after 1 April 2017 and sold after 31 March 2019 shall be taxable at the full domestic tax rate. All investments made in shares of Indian companies before 1 April 2017 are grandfathered and will continue to enjoy the exemption under the India-Mauritius tax treaty. The above-mentioned amendment does not apply to any asset other than shares in an Indian company (ie, gains arising from the transfer of any other securities issued by Indian companies will continue to be exempt from capital gains tax under the India-Mauritius tax treaty).

Aside from the above, the Financial Services Commission, Mauritius, has also notified requirements to be complied with by a Mauritius global business licence company – Category 1 (GBL-1) (which is the kind of company primarily used for Indian acquisitions) to be eligible for obtaining a TRC. These requirements essentially necessitate GBL-1 companies to have economic substance in Mauritius such as having office premises in Mauritius or employing a full-time Mauritian resident at a technical or administrative level or have arbitration in Mauritius, etc.

Similar to the revision in the India-Mauritius tax treaty, the tax treaty with Singapore has undergone a third revision since its inception on 24 January 1994, wherein a protocol has been inserted providing for taxing the capital gains arising out of sale of shares of an Indian resident company that have been acquired on or after 1 April 2017 in India. However, the shares acquired on or before 1 April 2017 shall be outside the scope of taxation in India and shall continue to enjoy the capital gains tax benefit in accordance with the erstwhile tax treaty provisions, subject to fulfilment of revised LOB provisions. The erstwhile India-Singapore tax treaty provided for a capital gains tax exemption in India in the case of transfer of shares of an Indian company, subject to the satisfaction of the LOB condition (ie, shares of the Singapore transferor company should be listed on a recognised stock exchange in Singapore or total annual expenditure on operations in Singapore should be equal to, or more, than S\$200,000 in the immediately preceding period of 24 months from the date the gains arise).

Transitional provisions have also been notified wherein a relaxation of up to 50 per cent of capital gains tax has been provided to capital gains arising on the transfer of shares acquired after 1 April 2017 but

before 31 March 2019 (ie, the transition period), subject to revised LOB provisions. Under the revised LOB provisions, the expenditure threshold shall be applied during the period of 12 months immediately preceding the date of gain.

The government had classified Cyprus as a notified (uncooperative) jurisdiction in 2013. However, subsequent to revision of the bilateral tax treaty on 18 November 2017, the government rescinded its notification. The amended India-Cyprus tax treaty provides for source based taxation of capital gains arising from sale of shares in the source country. Grandfathering provisions have been introduced pertaining to gain on sale of share investments made prior to 1 April 2017, in respect of which capital gains will continue to be taxed in the country of residence of the taxpayer. No LOB clause has been notified in the revised tax treaty.

#### General Anti-Avoidance Rule

Finance Act 2012 introduced the General Anti-Avoidance Rule (GAAR), which came into effect from 1 April 2017. GAAR provisions could apply if an arrangement is declared an 'impermissible avoidance arrangement'; in other words, an arrangement the main purpose of which is to obtain a 'tax benefit', and which satisfies certain other tests. The GAAR provisions effectively empower the revenue authorities to deny the tax benefit that was being derived by virtue of an arrangement that has been termed 'impermissible'.

Further, the GAAR provisions lay down certain scenarios in which an arrangement or transaction would be deemed to lack commercial substance if the situs of an asset or a transaction, or one of the parties to the transaction, is located in a particular jurisdiction only for tax benefit. Thus, interposing special purpose vehicles in a tax-friendly jurisdiction, devoid of any commercial substance or rationale, would be one practice that the revenue authorities would seek to challenge through GAAR. As per recent Central Board of Direct Taxes (CBDT) Circular No. 7 issued on 27 January 2017, where anti-avoidance rules (LOB) exist in a tax treaty, GAAR provisions should not be invoked in cases where such LOB provisions sufficiently address tax avoidance.

Recently India signed MLIs in support of the OECD's BEPS Action Plan 15. India opted for Simplified LOB (SLOB) and Principal Purpose Test (PPT) for all its CTAs. PPT is broader than Indian GAAR since under the Indian GAAR provisions, the 'main purpose' of an arrangement is to obtain tax benefit. As opposed to this, the PPT test is broader covering 'one of the main purposes' of entering into an arrangement is to obtain treaty benefit, as the decisive factor for identifying treaty abuse. Further, the PPT test has a carveout wherein treaty benefit is granted to a transaction if such benefit is in accordance with the object and purpose of the relevant tax treaty.

A notification has been issued by the government laying down certain exclusions from the scope of applicability of the GAAR provisions. The revenue authorities will not be empowered to invoke GAAR in the case of income arising to a person from a transfer of investments made before 1 April 2017. Further, the revenue authorities will not be empowered to invoke GAAR in cases where the tax benefit in a year arising to all parties to the arrangement (in aggregate) does not exceed 30 million Indian rupees. GAAR will also not apply to:

- foreign institutional investors (subject to certain conditions) who have invested in listed or unlisted Indian securities and have not obtained any treaty benefit;
- non-residents, in respect of their investments in offshore derivative instruments; and
- investments made prior to 1 April 2017.

#### Indirect transfers

The Finance Act 2012 introduced a retrospective provision for Indian taxation on any gains from transfer of shares (or interest) of an offshore company or entity that derives value substantially from assets located in India (indirect transfer provisions). CBDT issued a clarification in May 2012 directing no reopening of cases on account of indirect transfer transaction where the tax assessment stands completed and no reassessment notice was issued before 1 April 2012. Further, on 28 August 2014, a committee was formed comprising senior officers of the CBDT, namely the joint secretaries (FT&TR-I and TPL-I) and Commissioner of Income Tax (ITA) with the director (FT&TR-I).

## 4 Company mergers and share exchanges

### Are company mergers or share exchanges common forms of acquisition?

Mergers and demergers are preferred forms of acquisition in India. This is primarily due to a specific provision in the tax law that treats mergers and demergers as tax-neutral, both for the target company and for its shareholders, subject to the satisfaction of the prescribed conditions.

Other reasons why mergers and demergers are preferred are:

- the unabsorbed business losses and depreciation of the transferor company can be carried forward, subject to certain conditions. In the event of a merger, all the losses of the target company are transferred to the buyer, while in a demerger only the losses pertaining to the undertaking being sold are transferred. An undertaking is broadly understood to mean an independent business activity operating as a separate division on a going-concern basis comprising its independent assets, liabilities, employees and contracts. In a merger, the period of carry-forward of the unabsorbed losses is renewed for a period of eight years from the date of merger, while in a demerger, the unabsorbed losses can only be set off and carried forward for the unexpired period;
- generally, tax holidays and other incentives would continue to be available to the acquiring company. However, there are specific tax holidays that may cease to be available in the event of a merger or demerger; and
- transfer of prepaid taxes and other tax credits from the target company to the acquiring company is permitted in certain cases.

However, the ability to achieve a step-up in the cost basis of the assets is difficult in both mergers and demergers. Further, these involve a court or National Company Law Tribunal (NCLT) approval process, and, therefore, are at present time-consuming.

The government of India under the Companies Act 2013 (the Act) replaced the Companies Act 1956 with effect from 29 August 2013. The NCLT was constituted with effect from 1 June 2016, subsuming functions of four corporate regulatory bodies, namely the Company Law Board, High Court, Board of Industrial & Financial Reconstruction and the Appellate Authority for Industrial and Financial Reconstruction. The NCLT deals with all business reorganisations and acts as a single window approving authority for all business reorganisation schemes. Further, the Act specifically provides for simplified and faster processes for mergers and demergers for specified 'small private companies' and between holding and wholly owned subsidiary companies, whereby central government's approval is sought and the requirement to approach the NCLT for approval is absolved, subject to fulfilment of prescribed conditions.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

In the case of mergers and demergers, issuing stock as a consideration instead of cash consideration ensures the tax-neutrality of such mergers and demergers, subject to fulfilment of prescribed conditions. Apart from the above, there is no tax benefit to the acquirer in issuing stock as consideration instead of cash.

There could be tax implications in cases where shares are issued at a price less or more than the FMV.

In the case of shares issued at a premium to Indian residents (and not to non-residents), the issuer company could be made liable to tax for the amount of the premium received in excess of the FMV of the shares. The FMV for this purpose is a value that is the higher of the book value of the assets and liabilities of the issuer company determined as per the prescribed manner or the FMV of the stock determined by a merchant banker or an accountant as per the discounted cashflow method. This tax does not apply to venture capital undertakings issuing shares to a venture capital fund registered with the regulatory authorities in India.

In the case of issue of shares at a price less than their FMV, such FMV or the difference between the FMV of the shares received and the asset given up could be brought to tax in the hands of the recipient of the shares as ordinary income. FMV for this purpose is defined as the net asset value of the company issuing the shares, to be determined on the basis of book values of its assets and liabilities.



## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

All forms of business acquisitions involve transaction taxes in some form, though the nature, incidence and quantification of the taxes vary. Typically, these include stamp duty, GST, etc. The Indian government has introduced GST with effect from 1 July 2017. Stamp duty is payable on execution of a conveyance or a deed. GST is an indirect tax that subsumes an array of indirect taxes, namely excise duty, service tax, value added tax (excluding stamp duty) and is payable on the supply of goods and services. Who bears the stamp duty is negotiated between the buyer and the seller, although it is common for the buyer to bear it. GST, being an indirect tax, is normally collected from the seller and paid or borne by the buyer. Depending on the facts, the buyer may be able to offset the GST paid against its output GST liability, if any.

The impact of transaction taxes and applicable rates for different forms of acquisition are given below.

### Acquisition of stock

Transfers of shares in a company are liable to stamp duty at the rate of 0.25 per cent of the value of the shares. However, no stamp duty is levied where the stock is held in an electronic form with a depository (and not in a physical form). Securities transaction tax (STT) is applicable on purchase of shares listed on a stock exchange. There is no GST on the sale of shares since definition of 'goods' and 'services' under GST regulations excludes 'securities'.

### Acquisition of business assets

Acquisition of business assets as part of an acquisition of an entire business undertaking does not attract GST. GST should not apply on the sale of a business as a whole as an undertaking on a going-concern basis. Stamp duty would apply on specified movable property like 'towers' and immovable property if the transfer is undertaken by way of a conveyance. Stamp duty is a state levy and the rate of stamp duty would differ depending on the nature of the assets transferred and their location. Generally, however, stamp duty is payable only on the immovable property transferred on the basis that the movable property is transferred by way of physical delivery.

In the event of an acquisition of specific business assets, GST would be applicable on the transfer of movable assets. The rate of GST would depend on the nature of the assets and would vary within a range of 12 to 28 per cent. However, input tax credit for the same should be available to the payer (depending on the nature of the asset). The stamp duty implications would be the same as discussed above.

### Mergers and demergers

In most states, mergers and demergers attract stamp duty. The stamp duty is normally based on the value of shares issued as a result of the merger or demerger and the value of the immovable property transferred, pursuant to such a merger or demerger.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Unabsorbed business losses are allowed to be carried forward and set off for a period of eight years from the year in which they are incurred, while there is no time limit for carry-forward and set-off of unabsorbed depreciation.

Change in shareholding of a closely held company (ie, a private company whose shares are not listed on a stock exchange) by more than 49 per cent of shares carrying voting power in any year would result in such unabsorbed business losses not being eligible for carry-forward and set-off in the future. However, it does not affect carry-forward and set-off of unabsorbed depreciation, if any. Also, there is

no impact in certain other scenarios such as a change in shareholding as a result of amalgamation or demerger of a foreign parent provided 51 per cent of the shareholders of the amalgamating or demerged foreign company continue as shareholders of the resulting company. Tax credits (such as minimum alternate tax) or deferred tax assets are not impacted by a change in control of the target or upon its insolvency.

An exception has been made for eligible start-ups for carry forward and set-off of losses subject to the condition that shareholders having shares with voting power continue to hold such shares in the year of set-off and such loss should have been incurred from seven years of incorporation of such company. Furthermore, in the case of companies covered under the resolution plan under the Insolvency and Bankruptcy Code 2016, restrictions pertaining to a change in shareholding do not apply for such carry-forward and set-off of losses.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

### Deductibility of interest

#### Acquisition of stock

The deductibility of interest on acquisition finance used by the acquisition company to acquire stock in a target company would depend on the characterisation of income received from the target company; in other words, ordinary income versus investment income. Further, as a general rule under the domestic tax law, where any expense is incurred for earning tax-exempt income, no deduction is allowed for such expenditure. Recently, the Supreme Court in the case of *Maxopp Investment Ltd v CIT* (Civil Appeal Nos. 104-109 of 2015) held that if a taxpayer acquires shares of a company to gain controlling interest over the company and earns exempt income, the portion of the expenditure attributable to such exempt income should be disallowed. However, if the taxpayer holds the shares as stock-in-trade, then income earned shall be business income. Accordingly, expenditure incurred in relation to such income shall be deductible as a business expenditure.

### Acquisition of business

In the event of acquisition of business assets, whether in the form of a business as a whole or specific assets, the interest on borrowings, which is relatable to a capital asset, should be capitalised as the cost of the asset, while the interest payable on an ongoing basis should be allowed as a deduction, as such expenses would be incurred for the purposes of the business of the acquisition company.

### Withholding taxes on interest payments

Payment of interest by an Indian company to a foreign party that is a related party would be subject to Indian transfer pricing regulations, thin capitalisation provisions and restrictions under exchange control regulations. Under exchange control regulations, foreign loans are subject to maximum interest-rate ceilings on repayment schedules and end-use restrictions, such as the proceeds not to be used for on-lending, investment in a capital market, acquiring a company or a part thereof, repayment of an existing rupee loan and real estate (excluding development of integrated township as defined in the regulations). In the case of foreign-related party loans, arm's-length interest is allowed as a deduction. With effect from 1 April 2017, taxable deduction of interest expenditure claimed by an Indian company in excess of 30 per cent of earnings before interest, taxes, depreciation and amortisation (EBITDA) of such a borrowing Indian company shall not be allowed. Such disallowed interest can be carried forward up to the next eight years, to be allowable as deduction against future taxable income provided the deduction is maintained.

The strict source-based rule is applied for taxation of interest in India. Generally, the interest payable by a resident is taxable in India. However, in certain cases, interest payable by a non-resident is also taxed in India if it is payable in respect of any debt incurred for the business or profession carried on in India by such person.

Thus, the interest payments made from India would be liable to tax in the hands of the recipient and would, therefore, be subject to withholding tax implications. The rate of withholding tax would depend on whether the borrowing is in foreign currency or in Indian currency. In the case of monies borrowed in foreign currency before 1 July 2020, the rate of withholding tax would be 5 per cent (plus applicable surcharge and cess) on the gross amount. The withholding tax rate is more beneficial as compared to the treaty rate (at 7.5 to 15 per cent under various treaties). Interest payments on monies borrowed in Indian currency would be subject to withholding tax at the rate of 10 per cent (plus applicable surcharge and cess) on a gross basis.

### Debt pushdown

Debt pushdown for offshore financing for acquiring an Indian company or business assets is not feasible due to Exchange Control restrictions and thin capitalisation rules. On the other hand, debt pushdown by way of local financing (through banking institutions) procured by an Indian company for acquiring either stock or a business asset is not common due to restrictive banking and corporate regulations. Accordingly, careful planning and structuring is required for achieving tax optimised debt pushdown.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

In the case of a stock acquisition, the seller normally warrants that the target has been compliant with all tax matters and that all disputed matters are either provided for or otherwise disclosed. An indemnity is provided if there are any tax dues that arise over what is disclosed and the seller shall indemnify the buyer for such claims. Since tax dues can arise several years later, indemnities are provided for a seven-to-10-year period, often without any monetary cap unless they are quantifiable. To implement the indemnity, part of the consideration could also be placed in an escrow account particularly if a claim of tax administration is imminent. These aspects are documented in the share purchase agreement entered into between the parties. The buyer could also insist that the seller obtains a nil tax withholding order from the revenue authorities for tax withholding on consideration for such a sale, particularly in cases where the seller is claiming capital gains tax exemption under a favourable tax treaty or where tax on an offshore acquisition of shares with underlying assets are exempted due to the threshold.

In the case of an acquisition of assets and liabilities, the warranties and indemnities are less stringent, since the buyer does not acquire control over the selling company itself, and any tax dues would fall upon the selling company. The sale agreement should contain a general indemnity clause for indemnifying the buyer against representations and undertakings made by the seller. Besides, a specific indemnity clause can also be placed indemnifying the buyer against any action that the revenue authorities may take on the buyer or assets acquired by such a buyer (or both). It is also common for the buyer to insist that the seller obtain a no-objection certificate from the revenue authorities for the sale of the assets (discussed earlier).

Payments made pursuant to a claim under a warranty or an indemnity are not liable to tax (for the recipient) if they are treated as a capital receipt and, hence, are not subject to withholding taxes. However, if the indemnity relates to a 'profit earning activity', it may be taxable in the hands of the recipient and subject to withholding taxes. The payer of the claims is unlikely to be able to claim the amounts paid as a deduction against its income on the sale of the stock or assets and liabilities.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

Post-acquisition restructuring would depend on the commercial and business objectives of the buyer. Consolidation with other subsidiaries

operating in India is often implemented. This is done by way of merger or reverse merger, slump sale or business transfer. Streamlining and alignment of the transfer pricing methodologies is an important post-acquisition step.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

A tax-neutral spin-off of a business can be achieved by way of a court or tribunal-approved demerger.

Demerger refers to transfer by the transferor (demerged) company of one or more of its undertakings to the transferee (resulting) company, subject to the condition that it is undertaken as per the Indian corporate laws and satisfies the following conditions:

- all the properties and liabilities of the demerged company become the properties and liabilities of the resulting company and are transferred at book value;
- the resulting company issues shares to the shareholders of the demerged company on a proportionate basis;
- shareholders holding a minimum of 75 per cent of the value of shares of the demerged company become shareholders of the resulting company; and
- the transfer of the undertaking is on a going-concern basis.

The concept of 'undertaking' is broadly understood as an independent business activity operating as a separate division comprising its independent assets, employees and contracts. Based on principles laid down by courts in India, an 'undertaking' would basically mean a separate and distinct business unit or division set up with identifiable investment and capable of being run and operated on a stand-alone basis.

A demerger that satisfies the above conditions is tax-neutral and the unabsorbed losses and depreciation pertaining to the transferred undertaking are allowed to be carried forward and set off by the resulting company for the unexpired period. Transfer taxes as discussed in question 6 apply even in the case of demergers.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Under Indian tax law, a company incorporated in India is always treated as a resident and taxed on worldwide income. Indian laws do not permit migration of residence of an Indian company to any other jurisdiction. However, an Indian company could have dual residential status and may be treated as a resident in another country. In such a case, the residential status of the Indian company would be determined as per the 'tie-breaker rule' provided under the tax treaties. A foreign company can be treated as an Indian resident if its place of effective management (POEM) during the year is in India. POEM has been defined to mean the place where key management and commercial decisions that are necessary for the conduct of the business of the foreign company as a whole are, in substance, made. The concept of POEM for determining residential status of a foreign company was introduced in the law from 1 April 2016.

The guidelines provide for test of 'substance over form' for determining POEM application. The active business outside India (ABOI) test has also been prescribed for determining POEM. For companies that do not meet the ABOI test, POEM determination is based on identifying or ascertaining the person or persons who actually make the key management and commercial decisions and the place where such decisions are made for conducting company's business. Location of the board of directors, delegation to committees, location of company's headquarters, place of residence of decision-makers or place of decision making are other important factors of determination of POEM in India. The law provides that if determination of POEM under tax treaty tie-breaker rules poses a conflict, it will be deemed that POEM is in India.



**13 Interest and dividend payments**

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

**Interest**

All interest payments by residents are liable to withholding tax unless such interest is paid for business carried out outside India. Interest payments by non-residents are liable to tax if they are made in relation to business carried out in India. Under the domestic tax law, the withholding tax is 20 per cent (plus applicable surcharge and education cess) on gross interest in the case of foreign currency loans. In cases where the monies are borrowed in foreign currency, before 1 July 2020 (subject to satisfaction of certain conditions), a lower interest rate of 5 per cent (plus applicable surcharge and education cess) on a gross basis shall be applicable. Interest received from an Indian rupee-denominated debt would attract withholding tax at a rate of 5 per cent (plus applicable surcharge and education cess) on a gross basis.

**Dividend**

Dividends distributed by Indian companies are exempt from tax in the hands of the shareholders; hence, no tax withholding applies. Finance Act 2016 brought to tax dividends in excess of 1 million rupees received by all taxpayers other than Indian companies and specified trusts and institutions at 10 per cent. Further, the company paying dividends is subject to DDT at the rate of 17.65 per cent (plus applicable surcharge and education cess) of the gross dividends. No treaty benefit is available under DDT. India has a concept of 'deemed dividend' wherein certain forms of payment (out of accumulated profits) such as distribution on liquidation or release of any part of assets of the company on reduction of share capital, etc, are considered as deemed dividend and subject to DDT.

In 2018, the law was amended to clarify that accumulated profits would include all profits belonging to the amalgamating and amalgamated companies as a result of past consolidations.

**14 Tax-efficient extraction of profits**

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Buyback of shares by a company was considered as a common tax-efficient means of extracting profits. As a general rule, the domestic tax law specifically provided that the proceeds received under a buyback will not be treated as dividends; instead they will be characterised as capital gains. Therefore, in cases where the shares in an Indian company are held by a foreign company, and if the relevant tax treaty provides that capital gains shall not be liable to tax in India, share buyback was an attractive option for repatriation of profits. In 2013, the introduction of buyback tax (BBT) at the rate of 20 per cent (plus applicable surcharge and cess) made such buyback tax inefficient for unlisted companies. In 2016, buybacks even under court-approved schemes attracted BBT.

The BBT is levied on the 'distributed income', representing the difference between consideration paid to the shareholders on the buyback of the shares and the amount received by the company on the issuance of such shares (irrespective of the amount the shareholder may have paid for acquiring the shares, in the event of a secondary acquisition). No treaty relief is available against BBT. If the shareholder subscribed to the shares at a premium, then buyback of shares may also be made at a premium without triggering adverse tax consequences, to the extent that the buyback price is not higher than the subscription price.

**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

In a cross-border situation, disposals are most commonly carried out by a sale of stock in the foreign holding company or a direct sale of the stock in the local company. In the Finance Act 2012, India introduced a retrospective amendment (with effect from April 1961) to tax indirect transfer of Indian assets implemented by way of transfer of shares in an offshore company by treating such offshore company shares as assets situated in India. This provision would be triggered if the offshore company's shares derive their value substantially from assets located in India. The same has been discussed in question 3. Such taxability of transfers in offshore holding companies with underlying Indian assets had been a matter of intense debate. The retrospective amendment seeks to nullify the ruling of the Supreme Court in the *Vodafone* case to make all indirect transfer of Indian assets liable to tax.

However, tax treaty relief would continue to be available to the non-resident seller. In one ruling, the High Court in the case of *Sanofi Pasteur Holding SA* (2013, 354 ITR 316) [Andhra Pradesh] upheld the availability of relief from tax on indirect transfers under the India-France tax treaty. The revenue authorities have appealed this ruling before the Supreme Court of India.

Where both the buyer and the seller are resident in India, disposal by way of sale of business assets is also common.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Under the domestic tax law, gains on disposal of stock in an Indian company by a non-resident company are liable to tax. Gains arising on transfer of listed stock held for more than 12 months is characterised as long-term, whereas gain arising from listed stock held for 12 months or less is characterised as short-term. For unlisted stock, the threshold period is 24 months for characterising the gain as long-term. Short-term gains arising on the sale of shares of an unlisted company are subject

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to tax at the rate of 40 per cent, whereas long-term gains on sale of unlisted securities are subject to tax at the rate of 10 per cent (without indexation and exchange rate difference). For listed-company equity stock, short-term gains are subject to tax at the rate of 15 per cent where shares are sold on the floor of the exchange. Long-term gains on the disposal of equity shares of a listed company on the floor of the exchange are subject to 10 per cent tax under the domestic law. In addition to tax at the above rates, it is required that surcharge and cess, as applicable, be paid.

The buyer is required to withhold taxes at the rates prescribed under the domestic tax law or the tax treaty law, whichever is lower, from such sale consideration to be paid to the non-resident seller. In the case of a failure to withhold taxes at applicable rates, the revenue authorities could initiate proceedings against the buyer and seek to recover the amount of short tax withheld. Withholding tax proceedings against the buyer are independent of the proceedings initiated against the seller. The buyer could be liable to pay interest at the prescribed rates on the amount of tax ought have been withheld as well as a penalty that is equivalent to the amount of such tax. We have discussed the capital gains implication on disposal of shares by a resident of a treaty country with which India has a favourable capital gains regime in article 3. We have also discussed the change triggered owing to change in the treaties with Mauritius, Singapore and Cyprus and implications under the GAAR law.

There are no specific provisions for real property, energy and natural resource companies in respect of capital gains taxation.

## 17 Avoiding and deferring tax

### **If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Gain arising on transfer of equity shares of a listed company (after holding them for more than 12 months) on the floor of the exchange are subject to a concessional capital gains tax rate of 10 per cent provided STT is paid. On the other hand, in case of sale of business assets, capital gains tax (for companies) on the gain arising on transfer of immovable property (after holding them for more than 24 months) is considered long term and taxed at 10 per cent, subject to indexation benefit. Gains up to 5 million rupees can, however, be sheltered by investments in bonds.

# Ireland

Peter Maher and Philip McQueston

A&L Goodbody

## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

There are a number of differences.

In a share purchase the purchaser assumes the historic tax liabilities of the company. In the case of an asset purchase, the purchaser does not generally assume past tax liabilities of the business.

Stamp duty is generally assessed on the transfer of Irish registered shares at 1 per cent of the consideration, whereas the sale of assets, subject to certain exemptions (eg, non-Irish situate assets, intellectual property and assets transferred by delivery only), may be assessed for stamp duty at the rate of 6 per cent of the consideration due. Stamp duty on transfers of shares of Irish companies that derive the greater part of their value from Irish real estate may, subject to certain conditions, also be assessed at the rate of 6 per cent.

Share sales are exempt from VAT. Irish asset sales are subject to VAT at rates of up to 23 per cent, although full VAT relief can be obtained where, broadly, the assets are being transferred as part of a transfer of a business.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

A purchaser will get a step-up in basis in the business assets of a company when buying the assets rather than acquiring stock. This may provide a tax benefit by reducing the gain on which tax is chargeable in the event that the purchaser sells the assets at a later date.

Capital expenditure on certain intangible assets like intellectual property, goodwill directly attributable to intellectual property, software and transmission capacity rights (as defined) may be depreciated for Irish tax purposes. Capital expenditure on other intangibles, not specifically accorded an entitlement to depreciation for Irish tax purposes under Irish tax legislation, generally does not benefit from tax depreciation. Similarly, the purchase of shares in a company will not of itself give rise to an entitlement to depreciate intangible assets owned by the company – of course, as explained, the company may itself have entitlement to depreciation allowances if it incurred capital expenditure on the purchase of qualifying intangibles.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

In the case of a stock acquisition, Irish stamp duty will be charged on the acquisition of shares in an Irish company regardless of whether the acquisition company is established in or outside of Ireland.

It may be advantageous to use an Irish-established, Irish tax-resident company as the acquisition company given that dividends

received by it from another Irish tax-resident company are tax-exempt in Ireland. The use of such an acquisition vehicle may also allow for the Irish substantial shareholdings capital gains tax exemption to be availed of.

Even if the acquisition company is not an Irish-established, Irish tax-resident company, it is likely, given the extensive exemptions from Irish dividend withholding tax, that dividends may be paid by the Irish target free of Irish dividend withholding tax if the acquisition company is internationally held. The use of a non-Irish tax-resident acquisition vehicle will not necessarily avoid a gain on the disposal of the stock being within the charge to Irish tax (see question 16).

In a business asset acquisition, if the business is intended to be carried on in Ireland after the acquisition, it may be preferable to use an Irish-established, Irish tax-resident acquisition company, as the carrying on of the Irish business by a non-Irish tax-resident company is likely to bring it within the charge to Irish tax by virtue of carrying on a business in Ireland. The non-Irish-resident acquisition company could thus be potentially liable to both Irish and foreign tax on the Irish business income.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

The Irish company law that came into force on 1 June 2015 allows two Irish incorporated private companies to merge, whereby the assets and liabilities of one company are transferred to the other and the transferring company is dissolved. Previously mergers between Irish companies were not possible. It remains to be seen whether or not Irish domestic mergers will become a common form of acquisition.

An Irish company may be merged with another company incorporated in the EU. A number of such mergers have been effected, but this is consequent to relatively recently introduced legislation, and generally in our experience has taken place within a group context, so it is not a common form of acquisition by third parties in Ireland at present.

Share-for-share exchanges are not uncommon forms of company acquisition. A share-for-share exchange may qualify for exemption from stamp duty subject to certain conditions.

A share exchange will most often arise where a publicly quoted company is acquiring the target company as the former has a ready market for its shares.

Where the shares of the acquiring company are issued to the shareholders of an Irish company as consideration for the acquisition of their existing shares, then, subject to certain conditions being satisfied, the transaction should qualify for Irish capital gains tax rollover relief for shareholders who would be within the charge to Irish capital gains tax on the sale. This relief provides that the selling shareholder is deemed not to have disposed of his or her shares in the original company and the new shares received in the acquiring company are deemed to be the same asset as the original shares with the same base cost and other tax attributes as the original shares. When the recipient of the shares subsequently disposes of the shares in the acquiring company for cash, shareholders who would be within the charge to Irish capital gains tax may be subject to tax at 33 per cent on the chargeable gain arising, subject to exemptions.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

In the case of a stock issue it may be possible to avoid the 1 per cent stamp duty charge altogether. Furthermore, the chargeable gain in the hands of the selling shareholder (if within the charge to Irish tax on the sale) may be deferred, which has indirect economic benefit to the acquirer.

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Yes. For further details on the stamp duty and VAT payable please refer to question 1.

In the case of a share sale, the accountable person to pay stamp duty is the purchaser of the shares.

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Trading losses may survive a change in control of the target. However, on the change of ownership of a company with trading losses, in certain circumstances a special provision applies to disallow the carry-forward of the trading losses if there is both a change in ownership of the target and a major change in the nature or conduct of the trade carried out by the target.

## 8 Interest relief

### Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

A tax deduction is available for the acquisition company for interest payments made by it in respect of borrowings to acquire the target, provided certain conditions are met.

There are no general thin capitalisation rules. However, restrictions have been introduced to disallow a deduction in certain circumstances, including in some cases where interest is paid on borrowings from a company that is connected with it and where the borrowings are used to acquire ordinary share capital of a company from a company that is connected with it.

The avoidance of withholding tax on interest payments is generally achieved by borrowing from a lender in an appropriate jurisdiction to which interest can be paid gross (see question 13).

Debt pushdown may be achieved with appropriate structuring. It may be necessary to have a subsidiary of the target company that is connected with the acquisition company, in order for the conditions allowing deduction to be met.

## 9 Protections for acquisitions

### What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

The accepted market practice in Ireland in a stock acquisition is for protection to be given by the seller to the buyer in the form of both a tax indemnity and tax warranties. A tax indemnity is generally given in the form of a separate tax deed. The documentation generally categorises

such payment as a reduction in the purchase consideration. To minimise the risk of taxability of payments, the purchaser rather than the target should be indemnified.

Tax warranties are also sought, primarily to provide the buyer with the necessary tax history of the company required to deal with tax matters going forward. In addition, the warranties may cover certain matters not covered by the tax deed. The tax warranties are included in the share purchase agreement.

Tax warranties are also commonly sought in a business asset acquisition but are minimal given the limited circumstances in which Irish tax liabilities may attach to assets. The tax warranties are included in the asset purchase agreement.

## Post-acquisition planning

### 10 Restructuring

#### What post-acquisition restructuring, if any, is typically carried out and why?

It cannot be said that there is any typical tax-driven restructuring done in Ireland post-acquisition of either shares in a company or business assets.

Of course, restructurings will often be put in place post-acquisition, with attendant tax consequences, but in our experience these are usually driven by the business requirements of the company and the group acquiring the target.

For example, we have advised on restructurings that have seen the businesses of other group affiliate companies of the acquirer move to Ireland in order to obtain the benefit of the low Irish corporation tax rate of 12.5 per cent.

Additionally, we have seen restructurings put in place post-acquisition to enhance the business and tax efficiency of the target company. One example might be a company with manufacturing operations in Ireland, which instead enters into a contract manufacturing arrangement, and such a structure needs to be carefully managed in order to preserve the entitlement of the Irish company to the 12.5 per cent rate of corporation tax.

Finally, restructurings are often put in place in order to extract cash from the acquired company.

### 11 Spin-offs

#### Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

It is possible for tax-neutral spin-offs of businesses to be executed in Ireland and for the trading losses of the spun-off business to be preserved. The transfer of a trade from one company to another is generally treated as the cessation and commencement of the trade, with trading losses not being available for use by the transferee. As an exception to this general rule, a provision allows a trade to be transferred from one company to another and, broadly, provided that the companies are in common ownership to the extent of not less than 75 per cent, the transferee is entitled to losses of the trade that arose while the trade was carried on by the transferor.

It is possible to avoid transfer taxes by executing a 'hive down and hive out' of a business, but various conditions must be met.

### 12 Migration of residence

#### Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

Irish incorporated companies are generally tax-resident in Ireland. There is an exception to this where an Irish-incorporated company that is regarded as resident in a treaty partner country of Ireland, and not resident in Ireland for the purposes of the tax treaty between that country and Ireland, will be regarded as not resident in Ireland.

For companies incorporated before 1 January 2015 a second exemption also applies (until 31 December 2020 or earlier in certain circumstances). Such an Irish-incorporated company that is under the ultimate control of a person or persons resident in an EU member state or in a



treaty country or which itself is, or is 50 per cent related to, a company whose principal class of shares is substantially and regularly traded on a stock exchange in an EU country or a treaty country, and that carries on a trade in Ireland or is 50 per cent related to a company that carries on a trade in Ireland, will not be tax-resident in Ireland if it is managed and controlled outside Ireland.

Where a company ceases to be resident in Ireland an exit tax regime applies. On ceasing to be resident, the company is deemed to have disposed of and reacquired all of its assets immediately before the event of changing residence, at their market value at that time, notwithstanding that no actual disposal takes place. The exit tax is disapplied in certain instances, including if the company is ultimately owned by a foreign company (ie, one controlled by a resident or residents of a country with which Ireland has a double tax treaty and not by an Irish-resident person).

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interest paid by an Irish-resident company is subject to withholding tax, currently at the rate of 20 per cent, absent an exemption. Under Irish domestic law various exemptions from interest withholding tax exist, in addition to exemptions provided for under certain Irish tax treaties.

Irish-resident companies are required to withhold tax, currently at the rate of 20 per cent, on dividends and other distributions. There are extensive domestic exemptions from this dividend withholding tax for non-Irish investors, subject normally to documentary filing requirements, and it is generally likely that dividends paid by an internationally held Irish company may be paid free of Irish withholding tax without having to rely on an exemption under a relevant Irish tax treaty.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

The making of a dividend or other distribution (whether in cash or in kind) is the most common means of extracting profits from an Irish company.

In certain cases there can be Irish company law impediments to the ability of an Irish company to make a dividend or distribution. Also, a dividend or distribution is not tax-deductible.

There are other means that could be adopted to extract profits effectively. With the introduction from 1 January 2011 of Irish transfer pricing rules (subject to certain exceptions and grandfathering provisions), such rules may now need to be considered in respect of these other means.

For example, interest could be paid on a loan made by an affiliate in a lower tax jurisdiction. The critical issues here would be to ensure that there is exemption from Irish withholding tax on the interest and also that the Irish company is entitled to a tax deduction for the interest paid, which is subject to detailed conditions.

Alternatively, if another income stream could be created from Ireland to a lower tax jurisdiction and if the payment was tax-deductible, then this could be a tax-efficient way for effectively extracting profits, such as if the Irish company was to license in intellectual property from an affiliate located in a lower tax country. The issue to ensure would be that withholding does not apply, that the licensor company is not regarded as receiving the income from an Irish source and that the payment made by the Irish company is not excessive, as the excessive element could be denied deductibility.

### Disposals (from the seller's perspective)

#### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The method of carrying out disposals very much depends on the particular circumstances of the transaction. The disposal of the stock in a local company or foreign holding company would generally be the most

### Update and trends

Despite uncertainty created by Brexit and US tax reform, Irish M&A activity has remained strong. As negotiations regarding the UK exit remain ongoing it is difficult to assess at this stage the potential effect that Brexit may have. Likewise, it remains too early to assess the impact of US tax reform on Irish M&A activity.

Recent and expected imminent changes to Irish tax law may also affect Irish M&A activity. The rate of stamp duty for business and asset sales has increased from 2 per cent to 6 per cent, while the stamp duty rate for transfers shares in Irish incorporated companies generally remains at 1 per cent. Certain specific measures have been introduced into Irish tax law to facilitate Irish domestic mergers of Irish incorporated companies, recently made possible under Irish company law. Changes to Irish tax law are expected to be made over the coming years to fully implement the BEPS project recommendations and to comply with Ireland's EU obligations under the EU Anti-Tax Avoidance Directives. For example, controlled foreign company rules are expected to be introduced into Irish law by the end of this year.

common method of disposal. This is driven in part by the seller wishing to avoid a double charge to tax, at both company and shareholder level, where the disposal is by way of an asset disposal.

The availability of the substantial shareholdings exemption (see question 17) may favour a disposal of stock rather than a disposal of assets.

The market practice in the case of a stock disposal for a seller of shares to give a tax indemnity and tax warranties for certain pre-completion tax liabilities of the target may, in certain circumstances, make an asset disposal preferable for the seller.

Differing Irish stamp duty rates (see question 1) may result in a buyer insisting on a stock disposal.

#### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

A disposal of stock in an Irish company by a company not resident in Ireland will be subject to tax in Ireland if the stock comprises unquoted shares deriving their value, or the greater part of their value, directly or indirectly from real estate in Ireland, Irish minerals or mineral rights, or exploration and exploitation rights in the Irish Continental Shelf.

#### 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

As regards the disposal of stock in a company, a non-resident company should only be subject to Irish capital gains tax on a disposal if the shares are of the type referred to in question 16. This assumes that the shares were held as a capital asset by the seller.

If the seller is a company resident in Ireland, then the provisions of the Irish substantial shareholdings exemption may apply whereby if, broadly, the seller owns more than 5 per cent of the share capital of the target company for the past 12 months and the target company is a trading company or part of a trading group, and is resident in an EU country (which includes Ireland) or in a country with which Ireland has signed a double tax treaty, the capital gains should be exempt from Irish capital gains tax.

To the extent that an Irish seller does not meet these criteria, one method of deferring the capital gains tax would be if the seller received shares from the acquiring company. As set out above, the gain is rolled over and will be realised on a disposal of those shares.

If the gain is taxable, there are a number of tax structuring routes that could be put in place to mitigate the gain. For example, in the case of an Irish corporate seller, effecting the disposal so that a large distribution is taken by the seller immediately before the sale.

As regards the disposal of assets, there is no opportunity for the vendor to roll over any gain as this rollover relief was abolished within the



past few years. Again, if the assets were used as part of a branch trade in Ireland or if the seller is resident in Ireland or ordinarily resident, then the gain will be within the scope of Irish capital gains tax. The circumstances of the transaction may allow some scope for tax structuring, such as the existence of prior losses within the group that could shelter the gain.

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# Italy

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The tax treatments of the purchase of shares is materially different from that of transfer of enterprise (assets and liabilities), with regard to both direct and indirect taxation.

With general reference to indirect taxation, the share purchase is subject to a fixed registration tax of €200,00, regardless of the form of the contract (see DPR No. 131/1986, and specifically, as to private agreement, see Tariff II, article 2; as to notarised and public deeds, see Tariff I, article 11).

On the contrary, the enterprise transfer is subjected to a proportional registration tax, to be applied with a proportional rate between 3 per cent and 9 per cent, depending on the kind of assets that the transferred enterprise consists of, unless the transfer is realised by a capital contribution (in which case a fixed registration tax of €200,00 is applied – see DPR No. 131/1986, Tariff I, article 4).

In both cases, no VAT is applied.

As to direct taxation, both the purchase of shares and the transfer of enterprise do not generate a taxable income for the purchaser. However, relevant consequences may derive from the concrete terms and conditions of the transfer, for both the seller, with reference to realised or hidden capital gain or capital loss on the company's or enterprise's assets, and the purchaser, with reference to its right to tax amortisation of the assets' accounting or hidden value. These consequences may derive from several factors, among which: (i) legal status of the purchaser and seller (natural person or legal entities); (ii) terms and conditions pursuant to which the transfer is executed (sale, barter, capital contribution, merger, division).

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In the event of enterprise transfer by way of sale, the purchaser is entitled to tax amortisation on the purchased items and to enter the same purchased items into the accounting assets, including intangibles and goodwill, at their purchase value, on the basis of which the capital gains and losses for the seller shall be calculated.

In the event of enterprise transfer by way of capital contribution between Italian residents, or when at least one of the parties is an Italian resident and the transferred enterprise is located in Italy, the purchaser is entitled to fiscally book the business assets at the tax value of the seller, and then, to re-evaluate them up to their fair value, paying a substitutive tax with the application of variable rates (12 per cent in case of revaluations up to €5 million; 14 per cent for revaluations between €5 and 10 million; 16 per cent for revaluation exceeding €10 million – see DPR No. 917/1986, article 176, ph 2-ter). In that case, the purchaser shall be also entitled to tax amortisation of the relevant revaluated values.

In the event of transfer of shares, the revaluation of the target company's assets shall be allowed, following to the merger between the purchasing company and the target company, by imputation of the merger deficit (which is the difference between the shares purchase price and the correspondent proportional value of the target company's net worth, annulled in consequence of the merger). This deficit can be also imputed to the target company's goodwill or other intangible assets, with the payment of a substitutive tax to be applied with different rates, depending on the amount of revaluation (see DPR No. 917/1986, article 172, ph 10-bis, referring to the above-mentioned article 176, paragraph 2-ter).

Particular rules are also set for the transfer by way of exchange of shares, in the form of barter or capital contribution, with the transfer of the target company's majority interest (see DPR No. 917/1986, article 175 and 177).

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

In principles, Italian law does not provide for any restriction on foreign investment in Italian companies (except for the need of official authorisations in specific business sectors). However, the investment through an Italian-based company can be useful in the case of purchase of shares and subsequent merger of the target company, for the step-up on the assets and for the benefit of the national consolidation tax regime, which allows the algebraic sum of the group companies' incomes and losses, including those of the purchaser and target company.

The Italian residence of the purchaser also has to be considered in order to plan tax efficiency strategies or further business development in Italy.

On the other hand, the foreign residence of the purchasing company has to be considered for the purposes of the transfer pricing tax rules concerning interests, dividends, royalties or service considerations, and the possible application of withholding taxes, also taking into consideration that more favourable rules are provided for foreign or EU-based shareholders.

Different rules are also provided for the possible purchase of an Italian enterprise by a foreign entity that has set up a permanent establishment in Italy.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

The merger represents a widely used operation in Italy, since it allows the companies to improve their efficiency, mainly through the elimination of unnecessary corporate structures and the adoption of unitary taxation of merged companies' incomes, with the possibility to benefit from the deduction of the costs supported for the merger process, of the step up on the incorporated company's assets, and of a favourable substitutive tax (see DPR No. 917/1986, article 172, ph 10-bis).

Share exchange is less common in Italy, as it means that the two companies stay in existence and are taxed separately (unless they opt for the national or global consolidation regime, pursuant to DPR No. 917/1986, article 17 and following, and 130 and following), without

being entitled to the step-up on the assets of the company whose majority interest is acquired. However, share exchange could represent a useful alternative to a merger when the minority shareholders of the acquired company have not become shareholders of the acquiring company, or when it is preferable to keep the two entities separate in order to proceed easily to a future sale of the target company.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

The purchase of a participation through the issue of own shares by the acquiring company is an operation called 'contribution or exchange of shares', which is differently regulated whether the purchaser acquires a majority shareholding in the target company or not. Furthermore, the regulation is different depending on whether the transaction is executed between companies that are resident for tax purposes in Italy, or in a member state, or in an extra-EU country. A fiscal neutrality regime is provided for the transfer of a majority shareholding between companies resident in Italy or in the EU, if the operation is executed without changing the fiscal values for both the transferor and the transferee (see DPR No. 917/1986, articles 175 and 177). Otherwise, the acquisition of shares, through payments in cash, is taxed if it generates capital gain, unless the seller is an Italian company and the participation exemption regime (Pex regime) is applicable (if all the following circumstances pursuant to article 87 of DPR No. 917/1986 are met: (i) the seller has been the owner of the sold shares for 12 months before the sale; (ii) the sold shares have been entered in the balance sheet into financial fixed assets; (iii) the sold shares have not been issued by a blacklisted company; and (iv) the sold shares have been issued by a commercial company).

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

In the case of transfer of shares or stocks, both the purchaser and the seller are and jointly and severally bound to payment of a fixed registration tax of €200,00 (see DPR No. 131/1986, and specifically, as to private agreement, see Tariff II, article 2; to notarised and public deeds, see Tariff I, article 11). The parties may reach an agreement for a different allocation of expenses that is only valid for their internal relationship, and remains not relevant for the Italian tax authority.

The transfer of enterprise is liable to registration duty, at proportional rate, between 3 per cent and 9 per cent, depending on the assets, which make up the transferred enterprise. In addition, if business assets include real estate, the buyer shall also pay mortgage taxes and cadastral duties (currently at fixed aggregate amount of €100,00).

In the case of contribution of enterprise or shares, the parties shall pay a fixed registration tax of €200,00 (see DPR No. 131/1986, Tariff I, article 4).

None of the above-mentioned operations is subject to VAT and other taxes.

A stamp duty tax is due (see DPR No. 642/1972, Tariff I, article 1-bis) if the above-mentioned transactions are concluded by notarial deed or notarised private deed.

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

The tax losses of Italian companies, generally deductible for ordinary companies (up to 80 per cent of the taxable incomes of the following tax periods and for the entire amount that can be balanced by such incomes – see DPR No. 917/1986, article 84, ph 1), can no longer be deducted when the majority shareholder and the corporate purpose of the acquired companies change, except in the case of the following

vitality indexes: (i) the company has employed at least 10 employees during the past two years before the transfer; (ii) the company has recorded in the year before the transfer an amount of revenue and proceeds from its main business activity equal at least to 40 per cent of the average revenues and proceeds recorded during the previous two years; (iii) the company has paid during the past year before the transfer of an amount of salaries at least equal to 40 per cent of the average salaries paid during the previous two years (see DPR No. 917/1986, article 84, ph 3 (b)).

Pursuant to article 172, ph 7, DPR No. 917/1986, the same revenue and proceeds vitality indexes listed above must be met for the deduction of the tax losses in the event of a merger.

The purchaser can benefit from the tax credits of the acquired company without any restriction, in the case of change of control or merger.

In the event of change of control, funds under a conditional tax suspension regime maintain such a regime, while, in the case of merger, the maintenance of such a regime is subject to the conditions that the funds are also constituted in the balance sheet of the incorporating company at first using all the merger deficit (if any).

Particular rules (provided for by articles 83 and 88 of DPR No. 917/1986) apply to insolvent companies, indiscriminately if in bankruptcy or in composition with creditors.

## 8 Interest relief

### Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

The Italian resident purchasing company is entitled to deduct the interest paid for the acquisition of the (Italian or foreign) target company, provided that the limit of gross operating profit (earnings before interest, taxes, depreciation, and amortisation, EBITDA) ratio requirement is met (see DPR No. 917/1986, article 96). If the financier is foreign, the same rule applies, but it is important to consider the withholding taxes levied on the paid interest in the light of the rules set by the bilateral conventions against double taxation.

If the foreign financier is a related party, so belonging to the same group, it is also necessary to consider the possible application of the transfer pricing rules (see DPR No. 917/1986, article 110).

The withholding taxes on the paid interest may be avoided with good management of a funding operation. Moreover, if the buyer is resident in Italy, the deductibility of the paid interest from the income of the target company (the 'push down') may be obtained through the merger or through the adoption of the national consolidation tax regime (or, provided that stricter requirements are met, of the global consolidation tax regime).

In Italy there is no 'capitalisation rule', but there is a limit to deduction of passive interests paid in relation to the gross operating profit result (which is the EBITDA – see DPR No. 917/1986, article 96).

In the case of merger, the interest deduction of the passive interests of the companies taking part in the merging process is also governed by special rules (see DPR No. 917/1986, article 172, ph 7).

## 9 Protections for acquisitions

### What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

In deals for stock and business asset acquisitions, warranties and indemnity provisions are recurrent. They can be variously structured and, in general, they provide either an indemnity for the buyer or a payment to the target company or entity, with collateral given by third parties (such as banks or insurance companies).

In general, the events and matters covered by the warranty provision, as well as the expiration term, should be specifically identified, especially for a stock acquisition, since, in this case, the acquired is the stock (shares, participation). According to Italian law, this means that,

unless otherwise specifically provided, the seller guarantees the shares, as to the proprietorship, the face value and the rights attached to them (ie, voting rights), but not the assets of the company (and therefore the value) whose stock is sold.

Within business asset acquisitions, a common (and advisable) protection for the buyer is to ask for a certification by the Tax Agency as to pending proceedings or debts, since the buyer is held jointly liable with the seller for the taxes due by the latter for the fiscal year in which the acquisition occurred and the two previous ones.

Warranties and indemnities should be documented in writing, in the relevant agreement or side letters with a certified date, and so should the related claims and replies, even though the written form is not compulsory.

The indemnity or payment provided brings different effects from a fiscal point of view, depending on the structure chosen. As a rule, indemnity paid to the buyer is a price adjustment, so it is not taxed and not subject to withholding tax. Payment made to the target company instead is a contingent asset and taxable income of the target company, unless it can be qualified as a contribution by stockholders (see DPR No. 917/1986, article 88, ph 4).

## Post-acquisition planning

### 10 Restructuring

#### What post-acquisition restructuring, if any, is typically carried out and why?

Post-acquisition restructuring is very common when the acquisition brings the control of the target company, usually fit for the purposes of the business plan assumed for the acquisition, in most cases replacing directors and auditors, except for special agreements with minority shareholders, if any.

Often, the finances and organisation of the target company are restructured and no strategic assets are sold. Usually, the acquiring entity enters into agreements and relationships with the target company, providing services of direction, cash pooling and cost sharing.

Such agreements and relationships must be carefully verified taking into account transfer price rules and regulations and double tax treaties involved, when the target company is Italian and the acquiring company is foreign.

### 11 Spin-offs

#### Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

As a general rule, in Italy, when the spin-off is achieved by selling business assets, the related gain or loss (given by the difference between the sale price and the book value) is included in the taxable income of the selling company.

This also triggers stamp duties equal to 3 per cent of the value of the business assets, 9 per cent to the extent it includes real estate (see DPR No. 131/1986, article 50 and rate schedule, Part I, thereto attached, article 1).

When the spin-off is made through contribution of the business assets into a company (existing or established for that purpose), it is fiscally neutral and does not trigger transfer taxes, provided that the book values recorded by both the contributing company and the receiving company are aligned in continuity. This means that the contributing company must replace the value of the business assets transferred with the value of the stock acquired and the receiving company must enter in its books the same value of the business assets transferred, without any fiscal adjustment.

Contribution of business assets into a company does not trigger proportional stamp duty (see rate schedule, Part I, attached to DPR No. 131/1986, article 4, No. 3).

Alternatively, split-up of company in two or more companies is fiscally neutral and does not trigger transfer taxes.

Loss of the company being divided can be preserved and deducted both by the latter and the recipient company, proportionally to the quota of the net worth respectively kept and transferred, as it results from the last financial reports, excluded the contribution made during the previous 24-month period.

The splitting-up of a company does not trigger proportional stamp duty (see rate schedule, Part I, attached to DPR No. 131/1986, article 4, No. 3 and No. 6b).

### 12 Migration of residence

#### Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

As to Italian law, the migration of the residence of an Italian resident company, whether an acquisition company or target company, does not trigger exit tax, provided that the migrating company creates a permanent establishment in Italy, including all the assets of the migrating company that existed at the time of the migration and at the same fiscal value (see DPR No. 917/1986, article 166).

Otherwise, the migrating company is taxed on the difference between the sale value (as per DPR No. 917/1986, article 9) and book value of its assets.

When migrating to an EU member state or to a state that entered into a cooperation agreement for tax assessment and collection with Italy, it is possible not to trigger immediate exit tax payment without creating in Italy a permanent establishment, if the migrating company files an application for tax suspension. Tax suspension expires when, according to Italian income tax law, assets are considered sold, or, in any case, 10 years after the migration. Alternatively, the migrating company can apply for payment of the exit tax in six equal annual instalments (see Decree of the Finance Ministry, 2/7/20140).

The above rules set for companies migration apply also to the migration of a permanent establishment in Italy of foreign companies.

### 13 Interest and dividend payments

#### Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

As a general rule, dividend payments to a foreign company by an Italian company are subject to withholding tax equal to 27 per cent. The foreign receiver is entitled to refund up to 11/20 of the tax proven to be paid definitively abroad on the same dividends by certification of the tax authority of the foreign state (see DPR No. 600/1973, article 27, ph 3).

When paid to a company resident in EU member states, or in states of the European Economic Area, and who is there subject to corporate income tax, the applicable withholding tax is equal to 1,20 per cent (see DPR No. 600/1973, article 27, ph 3-ter).

The Italian distributing company can avoid application of the withholding (see DPR No. 600/1973, article 27-bis, ph. 3), if it meets the requirements set out in EU Parent Subsidiary Directive (ie, when the foreign receiving company directly holds no less than 20 per cent of the stock of the Italian distributing company) it takes one of the forms listed in the EU Parent Subsidiary Directive, it is a EU resident, it is subject to corporate income tax without exemption, and the holding period is no less than a year (see DPR No. 600/1973, article 27-bis, ph 1). Requirements must be proved in writing before dividends are paid to the distributing company, as to form, residence and tax appliance, by certification of the state of residence of the foreign company, and as to the holding period in writing by the foreign receiving company.

Under the same conditions, the foreign company can apply for a refund of the withholding tax, if applied (eg, because certifications were not available at the time of the payment of the dividends).

Interest paid to a foreign receiver by an Italian company (other than account or deposit interests, such as interest paid by banks) are subject to withholding tax equal to 26 per cent, unless double tax treaty rules provide otherwise (see DPR No. 600/1973, article 26, ph 5).

As per EU Directive 2003/49/CE, withholding tax does not apply if the receiver of foreign interest is an EU resident, it takes one of the forms listed in said Directive, it is subject to corporate income tax without exemption, and when the receiver and payer are linked through participation in the stock (the first in the second, vice versa or by a third company) of no less than 25 per cent for no less than a year (see DPR No. 600/1973, article 26-quater).



**14 Tax-efficient extraction of profits****What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

After acquiring a target Italian company, the target company can be merged in the acquiring company, thus combining assets and incomes of the two companies and transforming the target company into a permanent establishment of the foreign acquiring company.

Often, the foreign acquiring company provides the target company with several centralised services, upon compensation not subject to withholding tax.

The target company can pay the foreign acquiring company royalties (eg, for a licence on a trademark or patent) that are subject to the same tax treatment as the interest (see previous paragraph 13) (ie, withholding tax equal to 26 per cent) unless double tax treaty rules provide otherwise (see DPR No. 600/1973, article 26, ph 5) and unless the EU Directive 2003/49/CE regime is applied.

A specific double tax treaty can reduce or erase withholding tax.

**Disposals (from the seller's perspective)****15 Disposals****How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

When the selling company is an Italian resident, it is normally more convenient, from a fiscal point of view, selling the shares of the target company, being it Italian or foreign, since the Pex regime in Italy provides that only 5 per cent of the capital gain is taxable, if the shares were continuously held for the previous 12-month period, the shares were classified as financial fixed assets in the financial reports, provided that the target company is not resident in a blacklisted state or territory and that it carries on commercial or industrial activities (see DPR 917/1986, article 87).

Business assets disposals can be treated in the same way, if made by contributing the business assets in a company and then selling the company stock in the Pex regime, where the business assets are recorded in the receiving company books at the same fiscal value they had in the contributing company books, and the holding period is referred to the assets (see DPR 917/1986, article 176, ph 3). In this case, however, it must be taken into account that the Italian tax authority often requalifies the operation as a sale of business assets for the purposes of stamp duty application (3 per cent to 9 per cent of the assets value) with assessments in several cases confirmed in court.

The choice of structure of the operation, in any case, depends on the specific characteristics of the group, the purpose and on the evaluation of all effects.

**16 Disposals of stock****Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Disposal of an Italian company's stock by a non-resident shareholding company is, as a general rule, is taxable in Italy (see DPR 917/1986, article 23(f)). Such capital gain, when realised by an EU resident through disposal of a participation of no more than 20 per cent, is not taxable, unless otherwise provided by a relevant double tax treaty. It must be taken into account that often double tax treaties, according to the OECD model, provide that such incomes are taxable in the seller's state of residence.

Disposal of stock in a real estate company does not benefit from the Pex regime, even if the seller is an Italian resident.

There are no special rules or regimes as to the disposal of stock in real estate, energy and natural resource companies.

**17 Avoiding and deferring tax****If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Disposal of the stock in an Italian company can be fiscally neutral, when realised through the contribution of a controlling shareholding or through a participation exchange that leads to a control quota acquisition, without a cash adjustment, when the shares contributed or exchanged were continuously held for the previous 12-month period and were classified as financial fixed assets in the financial reports, provided that neither company is resident in a blacklisted state or territory and that it carries out commercial or industrial activities (see DPR 917/1986, article 177).

Business assets disposals can be fiscally neutral if made by contributing the business assets in a company and then the company stock is sold in the Pex regime, where the business assets are recorded in the receiving company's books at the same fiscal value they had in the contributing company's books and the holding period is related to the assets (see DPR 917/1986, article 176, ph 3).

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# Japan

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

From the perspective of corporation (income) tax, an acquisition of stock in a target company generally has no effect on the tax attributes of the target company. Thus, if the target company has net operating losses deductible from the taxable income, they may be carried forward to the years after the acquisition under the requirements provided by the law. (See question 7 as to the limitations to carrying forward net operating losses.) However, as the nature of the acquisition of stock has no effect on the target company's tax attributes, step-up of the basis of the target company's underlying assets is unavailable. Further, amortisable goodwill is not recognised even if the purchase price of the stock exceeds the aggregated value of the underlying assets of the target company.

A buyer may further benefit from acquiring the stock in the target company. For example, no consumption tax, real estate acquisition tax and registration and licence tax are imposed on the purchase of stock.

Contrary to acquisition of stock, a buyer of business assets of the target company does not inherit the tax status of the target company (ie, the seller). The buyer is generally free from the potential tax liabilities of the target company. Further, goodwill may be recognised and the basis of the assets may be stepped up, which can be, except for certain assets including lands, depreciated or amortised for tax purposes. As a flip side, no benefit of net operating losses of the target company can be enjoyed by the buyer of the business assets.

However, unlike with stock purchase, in the case of asset purchase, consumption tax may be imposed on the asset transfers. Further, real estate acquisition tax and registration and licence tax are imposed on the transfers of real estates.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

As mentioned in question 1, a buyer of stock in a target company does not achieve step-up in basis of the underlying assets. In asset purchase, assets may generally be stepped up and depreciated or amortised for tax purposes.

In the case of purchase of intangibles, including goodwill, as a part of acquisition of business, the intangibles may be amortised for certain years specifically stipulated under Japanese tax law. Goodwill is amortised over five years, 20 per cent of the basis each year. On the other hand, no goodwill or intangible is recognised in connection with purchase of stock; therefore, no amortisation is available. See also question 1.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

It is preferable to establish an acquisition company in Japan if the foreign investor wishes to offset financing costs for the acquisition against the target company's taxable income. This is because the offsetting can be achieved either through tax consolidation or merger between the acquisition company and target company, and a tax consolidation or merger can only be conducted between Japanese corporations. On the other hand, if the foreign purchaser wishes to offset financing costs for the acquisition against its own taxable profits, it is preferable to acquire the Japanese target company directly.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Although we see mergers and share exchanges, within the meaning of Japanese corporate law, used in M&A transactions involving foreign entities, we are unaware of merger or share exchange conducted directly between foreign entities and Japanese corporations. This is for, rather than tax-related reasons, the corporate-law-related reason that according to the dominant view among practitioners, the corporate law of Japan does not allow such mergers or share exchanges. Note that there are M&A transactions designed to achieve the effects similar to those of mergers and share exchanges between a foreign entity and a Japanese corporation.

### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

Paying cash as consideration in restructure transactions, such as mergers, generally disqualifies the transaction from being recognised as 'qualified' restructuring for tax purposes. This means that by paying cash, the transaction will be categorised as 'unqualified' restructuring, where the capital gains and losses of the target company's assets will be recognised; net operating losses may not be able to be carried forward; and built-in losses of the target company's assets may not be utilised. However, certain exemptions to this rule were introduced on 1 October 2017. For example, if a merging company owns two-thirds of the shares of a merged company, the merging company's payment of cash to shareholders of the merged company is allowed in the context of qualified restructuring. Another similar exemption will be available in relation to certain share exchange transactions. Paying consideration by issuing stock is not the only requirement to be treated as qualified restructuring, but the benefit of issuing stock may be fulfilling one of the requirements of qualified restructuring.

## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

The documents specified in the law are subject to stamp tax. Although agreements of acquisition of stock are not taxable, various documents that may be produced in M&A transactions, such as business transfer agreements, merger agreements, real estate agreements and 'receipts of cash other than sales price or securities', are listed as taxable documents. Note that stamp tax is imposed only on the documents physically executed, and thus, electronic copies and documents executed out of Japan are not subject to stamp tax.

The rule to determine the amount of stamp tax varies according to the type of the documents. However, the amount of stamp tax does not exceed ¥600,000. Stamp tax is owed by the person who 'prepared' a taxable document, which means that in the case of agreement, both parties are jointly subject to stamp tax thereof.

Further, if real estate is transferred, registration and licence tax at a rate of up to 2 per cent and real estate acquisition tax at a rate of up to 4 per cent of the taxable value of the transferred real estate are applicable.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Although there is no provision that generally imposes limitation after a change of control, there are provisions applicable to specific types of deferred tax assets. For example, net operating losses in the target company that experienced change of control may be restricted as explained below.

In general, net operating losses of a corporation may be carried forward for the next 10 fiscal years (nine fiscal years, for the fiscal years commencing before 1 April 2018). Note that carry-forward of net operating losses is allowed only if the corporation files a 'blue return' upon an approval of a relevant tax authority.

It should be further noted that net operating losses can be utilised to offset only up to 50 per cent of the taxable income for each fiscal year, under certain conditions specified by the law. For example, this limitation may apply if the target company is a 'large company', within the meaning provided by the law, with more than ¥100 million in capital. In order for the limitation not to be applied, it may be worthwhile to consider reduction of the capital of the target company in some cases.

In M&A transactions, restrictions on the carry-forward of net operating losses may be triggered if more than 50 per cent of the ownership of a target company with the losses is acquired and any of the events specified by the law occurs within five years of the acquisition. For example, the restriction may be triggered if the target company ceases its previous business and receives a significant amount of investment or loan in comparison with the scale of the ceased business.

There is no comprehensive tax regime applicable to acquisitions or reorganisations of bankrupt or insolvent companies. However, some exceptions to the limitations to deferred tax assets are provided for the purpose of encouraging reorganisation of those companies. For instance, net operating losses of a corporation under the *kosei-tetsuzuki* revitalisation procedure are not subject to the nine-year limitation of carry-forward, which is mentioned above, if it is utilised to offset the benefit of debt relief provided by certain creditors specified by the statute.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interest is generally deductible from the taxable income of the paying corporation. Under this general rule, corporation (income) tax can be avoided in such a manner as follows.

A resident corporation can receive funding from its foreign shareholder in the form of a loan. In such an event, the resident corporation can reduce the amount of its profits (thereby reducing its corporation tax burden) by deducting the interest paid with respect to such loan under the general rule allowing such deduction as mentioned above. By contrast, dividends must be paid from the profits that are calculated after taking into account taxes. Therefore, a resident corporation may try to receive a loan from the shareholder and include the interest as a deductible expense rather than obtaining additional capital from the shareholder and distributing dividends to such shareholder.

To counter such a scheme, the thin capitalisation regime and excess interest regime may limit the deductibility of interest payable from the acquisition company to its foreign shareholders. Under the thin capitalisation regime, a resident corporation that receives a loan from its foreign parent company in the amount of more than three times the amount of capital contributed by such foreign parent into the resident corporation is not allowed to include in deductible expenses the interest corresponding to such excess. Further, the excess interest regime may be applicable to the interest payable from the acquisition company. Under the excess interest regime, 'net interest' payments to affiliated persons in excess of 50 per cent of the 'adjusted revenue' of a corporation cannot be offset against the corporation's revenues. The regime is not applicable if:

- the amount of 'net interest' paid to affiliated persons in a given fiscal year is not more than ¥10 million; or
- the total amount of interest paid to affiliated persons in a given fiscal year is not more than 50 per cent of the 'total interest payments' made by a corporation.

If both the thin capitalisation regime and excess interest regime apply to a corporation, the larger of the amounts disallowed to be deducted will be deemed to be the amount against which the revenues of the corporation in the relevant fiscal year cannot be offset.

Under the domestic statute of Japan, interest paid to a foreign lender is subject to withholding tax at the rate of 20.42 per cent, including reconstruction special income tax imposed until the end of 2037. However, the tax treaties entered into by the Japanese government basically comply with the OECD Model Tax Convention, and most of them limit the rate to zero or 10 per cent with several exceptions.

There is no rule generally prohibiting 'debt pushdown', which is allocating debts to a resident corporation by way of merger to reduce its taxable income by offsetting with interest payment of the debt.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

It is common for the seller of stock or business assets to provide indemnities or warranties regarding any undisclosed or potential liabilities of the target company or defect of the assets. The tax treatment of the payment made under such indemnities or warranties is fact-specific and cannot be determined without looking into facts in detail. However, the payment generally has the nature of compensation for the damage suffered by the recipient (ie, buyer or target company). If the payment is characterised as such, it is not subject to the withholding tax and is included in the taxable revenue of the recipient. Whether or not the damage is deductible is a separate issue that is determined by the character of the damage. If the damage is deductible, it will be offset

with the revenue accrued by receiving the payment under indemnities or warranties.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

It is common to conduct post-acquisition restructuring, such as consolidating the acquired company and existing subsidiary in Japan. However, the forms and reasons of such restructurings vary depending on the situation.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Japanese tax law recognises qualified reorganisation where assets are transferred at book value and the realisation of gains and losses are thus deferred for tax purposes. The reorganisation that may be recognised as qualified includes the one conducted in the form of company split, which can be regarded as spin-off of business in substance.

In the case of company split, the net operating losses of the spun-off business are preserved only upon the strict conditions, including being recognised as qualified company split, provided by the statute. The conditions become especially strict in the case of a company split taking place within five years of the parties entering into a parent-subsidiary relationship. In such a case, the conditions include the requirement of 'joint business operation', which can be broken down and summarised as follows:

- the business to be split off and that of the receiving company are related;
- the amount of sales, number of employees, capital amount and other such variables representing the size of the business of a party does not exceed approximately quintuple that of the other party;
- the size of the business to be split off does not exceed approximately double what it was at the time when the parties entered into the parent-subsidiary relationship; and
- the size of the business of the receiving company does not exceed approximately double what it was at the time when the parties entered into the parent-subsidiary relationship.

Alternatively, the conditions in the case above can be satisfied if:

- the business to be split off and that of the receiving company are related; and
- one or more persons of each party, who are in the managing positions specified by the statute (eg, CEO), are planned to be in the managing position of the receiving company.

Further, a new qualified tax spin-off, which allows a company (splitting company) to incorporate a new company (new company) with the splitting company's existing business (split business) and distribute shares of the new company to the shareholders of the splitting company (split company), became available on 1 October 2017. The new tax qualified spin-off is for companies that are not owned by a controlling shareholder (typically, listed companies). The conditions for the qualification are as follows:

- only the shares of the new company are distributed to each of the shareholders of the splitting company in proportion to the number of the shares of the splitting company owned by such shareholder;
- no controlling shareholder of the splitting company exists immediately before the split and no controlling shareholder of the new company is expected to exist immediately after the split;
- any one or more directors or other executives of the splitting company immediately before the split are expected to become executives of the new company after the split;
- essential assets and liabilities of the split business have been transferred by the splitting company to the new company by the split;
- around 80 per cent or more of the splitting company's employees engaging in the split business are expected to engage in the split business operated by the new company after the split; and

## Update and trends

From the viewpoint of inbound investment by foreign investors, it should be noted that certain requirements for tax-qualified corporate reorganisation are relaxed. Continuity of the business is the key concept for a tax-qualified corporate transaction in Japan and requirements to maintain employees and business in relation to the target business in the corporate reorganisation discouraged the restructuring. After the tax reform of April 2018, a company that succeeded the business through a reorganisation is allowed to transfer employees and businesses to its group company with a 100 per cent control relationship after the reorganisation without affecting the tax-qualified status.

Another major reform encouraging inbound investment is that a shareholder's capital gains derived from the exchange of shares of a target company with newly issued or treasury shares of a purchaser company (including but not limited to takeover bids using treasury shares) will be deferred when the exchange is made, in accordance with a plan approved by the government under the Act on Strengthening Industrial Competitiveness after the reform effective as of 9 July 2018.

These may facilitate company reorganisation in collaboration with continuous economic growth in Japan under 'Abenomics'.

- the split business is expected to be operated continuously by the new company after the split.

In addition, another new qualified tax spin-off became available on 1 April 2018. A certain spin-off transaction, where a company (parent company) transfers a part of its business to its subsidiary with a 100 per cent control relationship and then distributes its shares of the subsidiary to shareholders of the parent company, was not tax-qualified. However, such spin-off transaction is now a recognised tax qualified reorganisation on the condition that the relationship between the parent company and the subsidiary is expected to continue immediately before the distribution of shares.

No consumption tax is imposed if the spin-off of business is achieved by a company split under Japanese corporate law. Real estate acquisition tax is potentially levied if real estate is involved, but may be exempt subject to the requirements provided by statute, including the requirement that approximately 80 per cent of the employees having engaged in the spun-off business are to be transferred to the company inheriting the business. Further, registration and licence tax at a rate of up to 2 per cent is levied.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Tax law defines a non-resident corporation, in substance, as a corporation not having 'its head office or main office in Japan'. This definition may appear to allow a corporation established under Japanese corporate law (eg, *kabushiki-kaisha* (or KK) and *godo-kaisha* (or GK)) to become a non-resident corporation for tax purposes by moving its head or main office to a jurisdiction out of Japan. However, Japanese corporate law requires that a corporation established under Japanese corporate law register its head or main office in a registration office of Japanese government. In practice, there is thus no method to migrate a corporation established under Japanese corporate law to another jurisdiction.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interest and dividend payments payable by a resident corporation to a non-resident corporation without a permanent establishment in Japan are subject to the withholding income tax. The rate for both interest on a loan other than bonds and dividends under the domestic law is generally 20.42 per cent, including reconstruction special income tax, while

the rate for interest on bonds of the resident corporation is generally 15.315 per cent. The rate can be relieved depending on the applicable tax treaty.

#### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

In addition to dividends and interest, it is common to extract the profit as service fees, which are not subject to withholding tax, if some service is actually rendered by the non-resident corporation. Further, royalties are utilised to extract the profit. Royalties are subject to withholding tax at the rate of 20.42 per cent (including reconstruction special income tax) under domestic law, which may be relieved by tax treaties to zero to 15 per cent.

#### Disposals (from the seller's perspective)

##### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The methods of disposals vary from case to case.

##### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

If a non-resident corporation has a permanent establishment in Japan and disposes stock in a resident corporation, the capital gains that arise from that disposal and are attributable to the permanent establishment will be subject to substantially the same corporation (income) tax that applies to resident corporations. The standard rate of corporation tax was reduced to 23.2 per cent from 1 April 2018.

On the other hand, a non-resident corporation that does not have a permanent establishment in Japan will not, in principle, be subject to corporation tax upon the capital gains arising from the disposal of stock in a resident corporation. This also applies to the case where the capital gains are not attributable to the permanent establishment in Japan of a non-resident corporation. This rule is subject to various exceptions, including that applicable if:

- the non-resident corporation, together with related person or persons, owns or has owned 25 per cent or more of the shares of the resident corporation at any time during a period of three years on or before the end of the fiscal year in which the shares are disposed; and
- the disposed shares are 5 per cent or more of the shares of the resident corporation.

Another exception is that Japanese corporation tax to capital gains will apply to disposal of shares in a real estate holding corporation, which is, roughly speaking, a corporation where at least 50 per cent of the assets consist of real estate located in Japan or shares of other corporations holding real estate located in Japan. If a non-resident corporation owns more than 2 per cent (in the case where the real estate holding corporation is not listed) or 5 per cent (in the case where the real estate holding corporation is listed) of the shares in the real estate holding corporation, then the non-resident corporation is subject to taxation to capital gains arising from the disposal of any of those shares.

Regardless of the exceptional rule above, however, the capital gains may be exempt from tax if the applicable tax treaty grants the exemption.

##### 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

As mentioned in question 16, a non-resident corporation is in general not subject to corporation tax on capital gains deriving from shares in a resident corporation if it does not have a permanent establishment in Japan or the gains are not attributable to the permanent establishment. It should be noted, however, that the exception to this general rule, as mentioned in question 16, is applicable. Gains accrued from disposal of the business assets by the local company are taxable. There is no general rule by which the local company can avoid or defer the tax.

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# Korea

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Investors may purchase a company by way of an asset purchase or a stock purchase. Each method has its own tax advantages and disadvantages.

#### An acquisition of stock in a company

**Advantages:** A buyer may benefit from the tax losses of the target company. Acquisition tax may not be levied on a share acquisition if the buyers and its affiliates collectively acquire, in aggregate, no more than 50 per cent of the shares in the target company.

**Disadvantages:** No deductions (for example, depreciation, amortisation) are available for the purchase price until the disposal of the shares. If the buyer and its affiliates collectively acquire, in aggregate, more than 50 per cent of the shares in the target company, the buyer will be subject to acquisition tax. The buyer and its affiliates, as a majority shareholder, bear secondary tax liability for the target company when the target company fails to pay tax.

#### An acquisition of business assets and liabilities

**Advantages:** the purchase price may be depreciated (or amortised) for tax purposes. Depreciation (or amortisation) can be offset against any taxable gains of the company.

**Disadvantages:** the buyer may be subject to acquisition tax on purchasing applicable assets. The benefits of any tax losses incurred by the target company remain with the seller. If a corporate buyer acquires non-business related assets, a certain portion of interest paid by the company is categorised as non-deductible expenses.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Assets and liabilities are valued in the course of an asset purchase, which may result in a capital gains tax liability for the seller and affect the depreciable amount for the buyer. Where a comprehensive business is purchased at its fair market value, the acquisition cost of the target business's assets may be stepped up (or down) to their fair market value. In this case, the buyer needs to apportion the total consideration to the assets acquired.

Goodwill is the excess amount of the consideration paid over the fair value of the net assets transferred. For tax purposes, goodwill can only be recognised if it is traceable to a valuable intangible asset and if an appropriate method has been used to calculate the goodwill. Goodwill can be amortised on a straight-line basis over a period of five years or more within the tax limit to the extent that the amortisation expenses are recognised for accounting purposes.

The depreciation cost of the assets charged in the accounts is deductible for tax purposes within the tax limit, provided it is

calculated based on the depreciation method and useful life stipulated for each type of asset under the Corporate Tax Act (CTA). Tax payers typically choose the straight-line method, declining-balance method or unit of production method to depreciate their assets.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Various tax incentives and benefits are designed to promote foreign direct investment in Korea. Foreign direct investment which meets a set of qualifications may enjoy exemption from or reductions in corporate income tax or business income, dividend income, earned income etc, and customs duties on capital goods as prescribed in the Restriction of Special Taxation Act (RSTA). However, there is no preference for an acquisition company's jurisdiction law.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Until now, mergers have been mostly used among Korean companies for corporate restructuring, such as consolidation of affiliates. Mergers involve a cumbersome process required under the Korean Commercial Act (KCA), and usually take six months or so to complete. Under the Korean tax laws, if the merger occurs for the purpose of corporate restructuring, the disappearing entity may receive a tax exemption on capital gain taxes on certain of its real estate transferred in the merger.

### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

There are no special tax benefits for the acquirer in issuing stock as a consideration rather than cash. However, if the merger conditions meet certain requirements such as the stock price being more than 80 per cent of the merger consideration, the acquirer is entitled to the tax deferred benefit of the merger purchase profit and benefits such as the transfer of the acquired corporation's carryover deficit, tax reduction and tax credits.

### 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

#### The acquisition of stock in a company

Security transaction tax: a securities transaction tax (STT) is imposed on the transfer of stock of a corporation established under the KCA or any special act, or on the transfer of an interest in a partnership, limited partnership or limited liability company established under the KCA. The Korea Securities Depository and financial investment business entities under Financial Investment Services and Capital Market Act are required to collect tax at the time of a transaction. The tax is computed by multiplying the tax base by the tax rate (0.15 per cent, 0.3

per cent or 0.5 per cent). Where the transfer price is lower than the fair market value in the case of a related-party transaction, the fair market value is used as the tax basis for calculating STT.

**Deemed acquisition tax:** In the case of a share transfer, acquisition tax is generally not levied. An exception applies where the invested company has certain statute-defined underlying assets (eg, land, buildings, structures, vehicles, certain equipment and various memberships) that are subject to acquisition tax. Where the investor and its affiliates collectively acquire in aggregate more than 50 per cent of the shares in the target company, they are deemed to have indirectly acquired those taxable properties through the share acquisition, so they are subject to deemed acquisition tax.

### **The acquisition of business assets and liabilities**

Stamp tax is levied on the transfer of certain assets listed in the Stamp Tax Act. The rate of stamp tax varies according to the asset acquired. Transfers of real estate are subject to stamp tax ranging from 20,000 to 350,000 Korean won, depending on the acquisition price.

Under Korean Local Tax Act, a company acquiring land, buildings, vehicles or certain memberships (eg, golf memberships, condominium memberships or sports complex memberships) is liable for acquisition tax, based on the transfer price, type and location of such taxable assets. In certain cases, the applicable acquisition tax rate is higher than the normal rate.

VAT on the asset transfer depends on whether the transfer is classified as an 'individual asset transfer' or 'comprehensive business transfer' under Korean tax law. In the case of an individual asset transfer, a seller should withhold VAT at 10 percent from a buyer and remit the collected VAT to the relevant tax authority. A comprehensive business transfer is exempt from VAT.

## **7 Net operating losses, other tax attributes and insolvency proceedings**

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Although there is no provision that generally imposes limitation after a change of control, there are provisions applicable to specific types of deferred tax assets. Preservation of net operating losses, tax credits and deferred tax assets is rendered possible by CTA, only in the case of qualified acquisition or acquisition with or among wholly owned subsidiaries to facilitate restructuring (reorganisation) of bankrupt or insolvent companies, as preservation of net operating losses, tax credits and deferred tax assets of target groups at the time of acquisition may result in an aggravated financial statement of the acquiring company and in the loss of tax revenue. Preservation of net operating losses, tax credits and deferred tax assets is not allowed in the case of non-qualified acquisitions. However, preservation of relevant reservations only is allowed in the case of preserving retirement and severance benefits and allowance for bad debts.

## **8 Interest relief**

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

The buyer can use debt or equity to fund its investment. The dividend is not tax-deductible, but interest can be deducted from taxable income. Expenses incurred in the course of borrowing, such as guarantee fees and bank fees, can also be deducted for tax purposes. Therefore, the buyer often prefers to use debt.

In general, interest expenses incurred in connection with a trade or business are deductible for Korean corporate tax purposes. However, certain interest expenses are not deductible, including (among others):

- interest on debt incurred specifically for use in construction projects or for the purchase of fixed assets;
- interest on private loans where the source is unknown;
- interest of the recipient that cannot be identified;
- interest on debt used for the purchase of non-business related assets; or
- interest paid to the foreign controlling shareholder that exceeds the limit under the thin capitalisation rules.

Under Korea's thin capitalisation rules, where a Korean company borrows from its foreign controlling shareholder an amount in excess of two times the equity from the foreign controlled shareholder (six times in the case of a financial institution), interest on the excess portion of the borrowing is not deductible in computing taxable income. Money borrowed from a foreign controlling shareholder includes amounts borrowed from an unrelated third party based on guarantees provided by a foreign controlling shareholder. The non-deductible amount of interest is treated as a deemed dividend or other outflow of income, and withholding tax (WHT) may apply.

## **9 Protections for acquisitions**

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

### **The acquisition of stock in a company**

Tax indemnities and warranties: in a share transfer, the buyer takes over all assets and related liabilities together with contingent assets and liabilities. Therefore, the buyer normally requires more extensive indemnities and warranties than in the case of an asset transfer.

Tax losses: in principle, on a change of ownership, the tax losses of a Korean company transfer along with the company.

Crystallisation of tax charges: since the purchase in a share transfer should assume the historical tax liability of the target company for the previous periods within the statute of limitations in Korea, it is usual for the purchaser to obtain an appropriate indemnity from the seller.

### **The acquisition of business assets and liabilities**

Tax losses or historical tax liabilities are not transferred with the assets in an asset acquisition. In the case of an individual asset transfer, the buyer does not incur a secondary tax liability for any unpaid tax or tax liabilities of the seller that relate to the transferred assets on the official transfer date. However, in a comprehensive business transfer, the buyer assumes a secondary tax liability on any already fixed and determinable tax liabilities of the seller on the official transfer date.

## **Post-acquisition planning**

### **10 Restructuring**

**What post-acquisition restructuring, if any, is typically carried out and why?**

With respect to share acquisitions, there is no change in the company's relations with its employees. For mergers, the surviving corporation assumes all of the merger company's labour liabilities by KCA and the Labour Standards Act (LSA).

In an asset transfer, the buyer will automatically assume the historical labour liabilities if the transaction is deemed to be a 'business transfer' under the standards provided in the LSA. If the transaction is deemed to be a business transfer, the buyer will be bound by the terms of existing employment agreements and other commitments by the LSA (unless the employees agree otherwise) for the employees being transferred to the purchaser. This may result in the transfer of severance obligations as well as employee liabilities arising from claims based on an existing employment relationship with the seller.

Acquisitions of companies under insolvency proceedings will be subject to the relevant bankruptcy laws and supervised by the court and court-appointed receiver. The acquisition transaction will also require approval by certain groups of creditors unless the transaction is permitted under the terms of an already approved plan.

For certain insolvent companies, a separate non-court workout procedure driven by creditor financial institutions is available under Korean law. In such workout proceedings, a committee comprising certain of the creditors performs the pivotal role in organising and implementing such procedures.

## 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

### Corporate income tax (CIT) relief

With respect to a division which meets the following requirements (that is, a qualified division), capital gains or losses on a transfer may be deemed nil:

- where a domestic corporation which has continuously operated a business for at least five years as on the registration date of the division, is divided upon meeting the following requirements:
  - the division involves an independent business category that can be operated after the division;
  - the assets and liabilities of the divided business category are comprehensively succeeded;
- where the total costs received by the stockholders of a divided corporation are in stocks, and such stocks are allocated in proportion to the stocks held by each stockholder of the divided corporation, and the controlling stockholders of the divided corporation hold such stocks until the end date of the business year in which the division is registered; and
- where a corporation established through division continues to operate the business succeeded to from the divided corporation until the last day of the business year in which the registration date of the division falls.

### STT exemption

No STT is levied where stocks are transferred for the purposes of a qualified division.

### Acquisition tax exemption

No acquisition tax is levied on property acquired on or before 31 December 2018 by the qualified division.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

It is possible for Korean companies to migrate to or continue their existence in other jurisdictions. There are no specific taxes in Korea relating exclusively to the migration of a company. To migrate into another jurisdiction, a Korean company must approve and file the respective corporate authorisations with the Korean Public Registry. If the migrating company ceases its operations in Korea, it will need to wind up its local business and cancel its taxpayer registration. Within 25 days of the date when the company ended all business operations, the company must file a final balance and income tax return, notify the tax authority and pay income tax for any remaining or leftover income. The company must pay the corresponding income tax due at closing.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Dividends paid to a non-resident are subject to WHT of 22 per cent unless the WHT is exempted or the WHT rate is reduced by a tax treaty between Korea and the other contracting state.

Interest paid to a non-resident is subject to WHT of 22 per cent (or 15.4 per cent for interest on bonds issued by the state, local government and a domestic corporation), unless the WHT is exempted or the WHT rate is reduced by a tax treaty between Korea and the other contracting state.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

It is common to extract the profit as service fees or royalties, which are not subject to WHT, if some service is actually rendered by the non-resident corporation. Fundamentally, the tax-efficient means for extracting profits from Korea vary from case to case.

## Disposals (from the seller's perspective)

### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Parties typically negotiate and enter into an agreement for acquisitions and disposals of shares, businesses or assets of privately owned companies. The process of acquiring a company varies depending on the nature of the deal participants and the complexity of the deal but, in the case of competitive bidding, the parties typically proceed in the following process:

- execute a confidentiality agreement, issue an information memorandum and process letter;
- conduct a preliminary bidding process and finalise the shortlist for preliminary bidders;
- conduct due diligence;
- circulate the seller's initial draft of the definitive agreement;
- conduct a formal bidding process (submit a bidding application and the buyer's mark up to the initial draft of the definitive agreement);
- select the preferred bidder;
- conduct confirmatory due diligence (as applicable);
- negotiate and execute the definitive agreement;
- prepare closing deliverables and satisfy closing conditions; and
- closing.

In addition, while the duration of the acquisition process may vary depending on the nature of the deal and the dynamics among the transaction parties, it could take anywhere from a few months to half a year or longer.

### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Generally, non-residents of Korea are liable to capital gains tax on Korean securities at the lower of the following rates:

- 10 per cent of the gross proceeds realised from the sale (11 per cent, including the 10 per cent surtax); or
- 20 per cent of the net capital gain (22 per cent, including the 10 per cent surtax).

Residents of countries that have concluded a double taxation agreement (DTA) with Korea, or countries with reciprocity rules, will, based on their investment registration card, either be exempted or be taxed, depending on the DTA. And the Korean government offers investment incentives (for example, tax exemptions and tax deductions) to companies engaged in certain high-tech activities or located in foreign investment zones, free economic zones, free trade zones and special industrial complexes. Many of these incentives are found in the Foreign Investment Promotion Act and RSTA.

### 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

#### CIT relief

If a company transfers all of its assets to another company in exchange for shares or interests in the other company and dissolves itself, the seller may avoid paying CIT on capital gains by treating the transfer price of these assets as the book value of these assets.

No acquisition tax is levied where:

- property is acquired no later than 31 December 2018 by a qualified merger;
- property is acquired in the course of a qualifying investment in kind;
- where a corporation becomes a holding company under the prescribed fair trade laws. Acquisition tax may be reduced by 75 per cent on real estate acquired by any of the following enterprises within four years from the date of its incorporation, provided that the acquisition is made in order to conduct relevant business;
- a small or medium-sized enterprise incorporated no later than 31 December 2020 in an area other than an over-concentration limitation zone of the Seoul Metropolitan area (small or medium-sized start-up enterprise); and
- an enterprise verified no later than 31 December 2020 as a venture business within three years of the date of incorporation (small or medium-sized start-up venture business).



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# Lithuania

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Regarding tax on corporate income, the acquisition of stock as such usually does not influence the balance of the profit and loss of the Lithuanian company being acquired. However, under specific conditions Lithuanian tax laws allow transfer of all or a part of losses for 2010 and subsequent years within the group of legal entities, including cross-border transfers. On the other hand, an acquisition of stock or an acquisition of business assets will affect the balance of the acquirer. Moreover, in an acquisition of a separate unit of property, rights or obligations, and subject to further activities in Lithuania, the acquirer may be recognised as acting through its permanent establishment in Lithuania, which may lead to the taxation of income of that activity in Lithuania.

The taxation of profit from further sales of purchased property differs as well. Profit on the sale of shares received by an acquirer with no other presence in Lithuania is not subject to tax on corporate income, but the sales of separate units of assets and liabilities might be. For example, subject to the Law on Corporate Income Tax (Law on CIT), profit from the sale of real property located in Lithuania is subject to a 15 per cent tax on corporate income.

The above-mentioned two forms of acquisition differ with respect to VAT. Pursuant to the Law on Value Added Tax (Law on VAT) the sale-purchase of stock is not subject to VAT in Lithuania, even if the company whose stock is being purchased owns the real property. The transfer of the whole or a part of a business, as a complex unit of rights and obligations (including cases where the whole or a part of a business, as a complex, is transferred as a contribution of a member of the legal person), to the taxable person who continues the acquired activity, is also not subject to VAT. According to the currently valid laws, the transfer of property during a reorganisation where the transferor is being dissolved may be subject to VAT. If the purchase or import VAT from a particular property or business activity was deducted, the corresponding acquisition of such property shall be subject to VAT in Lithuania.

If only a separate unit of property, rights or obligations is being purchased by the investor, such a purchase must be evaluated individually with respect to VAT. For example, the sale or purchase of real property that is deemed to be old according to the provisions of the Law on CIT in general is not subject to VAT in Lithuania, contrary to the sale or purchase of new real property.

It should also be noted that a foreign company owning real property in Lithuania must be registered in the register of taxpayers and pay the tax on real property, which is between 0.3 per cent and 3 per cent of the property's taxation value per year. The owner of the stock of a Lithuanian company does not have to pay any taxes related to the ownership itself.

Finally, a transaction concerning a sale or purchase of stock needs to be certified by a notary only in particular cases (eg, in cases where 25 per cent or more shares of private limited company are sold or where the sales price exceeds €14,500 despite the number of shares on sale), but the transfer of a whole or a part of business as a complex unit of rights and obligations must always be certified by a notary.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

The purchaser may get a step-up in basis if the business assets of the company are purchased or exchanged for other property.

Under the Law on CIT, the income of a Lithuanian or foreign entity through its permanent establishment in Lithuania, received from the increase in the value of assets resulting from transfer of shares of a target entity, shall not be taxed in Lithuania in the event that:

- the target entity is registered or otherwise organised in a state of the European Economic Area (EEA) or in a state with which a treaty for the avoidance of double taxation is in force; the target entity is a payer of corporate income tax or an equivalent tax; the entity transferring the shares held more than 10 per cent of voting shares in the target entity for an uninterrupted period of at least two years; and the entity transferring the shares does not transfer them to the entity that has issued these shares; or
- the shares of a target entity are transferred during the specific types of reorganisation referred to in the Law of CIT; the transferring entity held more than 10 per cent of voting shares in the target entity for an uninterrupted period of at least three years; and the entity transferring the shares does not transfer them to the entity that has issued these shares.

In accordance with the Law on CIT, the acquisition price of assets comprises expenses incurred for acquiring the assets, including commission paid and taxes related to the acquisition, except for VAT. Still, in an exchange of business assets for other assets the acquisition price of the newly acquired assets is the acquisition price of the assets exchanged. If the acquisition price of the assets exchanged cannot be determined, the acquisition price of the newly acquired assets will be their actual market price. It should also be noted that where securities are exchanged for other assets, the acquisition price of such assets shall be the actual market price of these securities at the moment of the acquisition of the assets.

Long-term assets and goodwill can be depreciated or amortised pursuant to the provisions of the Law on CIT.

Where the activity of another company as a complex, or a part of an activity constituting an independent unit capable of engaging in the commercial activity at its own discretion, is acquired, the value of positive goodwill is subject to depreciation for tax purposes for at least 15 years applying the linear method. Negative goodwill, created as a result of the above-indicated acquisition of the activity of the other company or a part thereof, shall be attributed to income at the moment of its acquisition.

Negative goodwill, as well as positive goodwill, created as a result of acquisition of stock aiming for control over the target's net assets and activity, can correspondingly be attributed to income or can be included in the limited allowable deductions for taxation purposes only after a subsequent merger of these companies or merger by acquisition of one company by another, if any.

The other purchased long-term intangibles can be depreciated for a minimum of two to four years, depending on the class of the assets and the manner of their use, applying the linear or double declining balance method.

### 3 Domicile of acquisition company

#### Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

For taxation purposes the acquirer can profit from tax exemptions in Lithuania if it is established in another EU member state, taking into consideration that the taxes due in that state are lower than the Lithuanian rates.

For example, dividends paid by a Lithuanian company to a foreign company that uninterruptedly for at least 12 months controls not less than 10 per cent of the voting stock in a Lithuanian company shall not be subject to taxation in Lithuania, except where the recipient of dividends is registered or otherwise organised in target (tax haven) territories. For comparison, dividends paid out to a company that does not correspond to the above criteria are taxed at 15 per cent on profit in Lithuania, unless a particular treaty on avoidance of double taxation provides for a more favourable regime.

Regarding taxation of interest, according to the currently valid Lithuanian tax laws, the interest on a loan paid by a local company to a foreign company organised within the EEA, or within a state that has a treaty on avoidance of double taxation with Lithuania in force, and not received through the foreign company's permanent establishment in Lithuania, is exempt from withholding tax on profit in Lithuania. For comparison, interest paid out to a foreign company that does not correspond to the above criteria is taxed at 10 per cent on corporate income in Lithuania, unless a particular treaty on avoidance of double taxation provides for a more favourable regime.

The royalties paid by a Lithuanian company to a related EU company (the beneficial owner), both corresponding to the criteria established by the Law on CIT, are also exempt from withholding tax in Lithuania when the royalties paid by a Lithuanian company to another foreign company with no permanent establishment in Lithuania are subject to 10 per cent withholding tax on profit in Lithuania, unless a particular treaty on avoidance of double taxation provides for a more favourable regime.

Furthermore, only a foreign entity, being the EU resident for taxation purposes, is able to transfer all or a part of its losses to the related Lithuanian entity.

Finally, under the Law on CIT only mergers, divisions or acquisitions with participants residing in the EU may be exempt from tax on corporate income on the capital gains and award a benefit for the acquirer to carry forward the losses of the acquired or transferring entity. In other cases the increase in the value of assets emerging from mergers and other forms of reorganisation or transfer shall be subject to tax on corporate income in Lithuania.

### 4 Company mergers and share exchanges

#### Are company mergers or share exchanges common forms of acquisition?

Both mergers and share exchanges have their own pros and cons. For example, if the merger corresponds to the requirements of the Law on CIT, the increase in the value of assets emerging from the merger shall be exempt from the tax on corporate income in Lithuania. Moreover, if the acquiring entity continues the activity taken over, or a part thereof, for a period not shorter than three years, it may carry forward the losses of the acquired or transferring entity or entities (except for the losses resulting from transfer of the securities or from derivative financial instruments) related to the transferred activity incurred before the completion of the reorganisation or transfer and not carried forward to the following year. On the other hand, the merger may be an incentive for the Tax Inspectorate to start a tax inspection of the transferor, of the acquirer or of the target, which may significantly prolong the merger process.

Some share exchanges can provide the above-mentioned tax advantages as well. In addition, they usually do not trigger tax inspections and the procedures are less time-consuming in comparison with company mergers.

Therefore, the most acceptable and efficient form of acquisition of a business or a part of it should be investigated carefully with respect to the individual situation, the kind of business being acquired and the goals of the acquisition. However, in practice mergers are more common than share exchanges in Lithuania.

### 5 Tax benefits in issuing stock

#### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

In general, Lithuanian tax laws do not provide obvious tax benefits to the acquirer in issuing stock as a consideration rather than cash. Still, if the issue of stock as a consideration falls under the provisions of the Law on CIT regulating tax-free mergers and acquisitions, the acquirer may benefit from the exemption of taxation of capital gains resulting from the merger and from the possibility of carrying forward the losses of the acquired or transferring entity. On the other hand, issuing stock as consideration may lead to the different estimation of the acquisition price of either stock or business assets acquired that may be important for the acquirer for future transfers of the acquired property.

### 6 Transaction taxes

#### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

There are no stamp duties payable for the acquisition of stock or business assets as such.

However, subject to the Civil Code, some transactions, such as transactions on transfer of ownership of real property and on transfer of all or part of a company as a complex unit of rights and obligations, must be certified by a notary. This requirement means additional notary expenses for the parties, amounting to 0.45 per cent of the value of the transaction, but no more than €5,792.40. Starting from 2015 particular sales of shares also require certification at the notary (see question 1) which leads to additional notary expenses amounting to 0.4–0.5 per cent of the securities' sales price, but no more than €5,792.40. The other transfers of stock do not have to be certified by a notary, although that is possible at a party's request.

Additionally, the Register of Legal Persons of Lithuania must be informed of any change in shareholders or their share in the company by submitting the renewed list of shareholders to the Register. In this case the state levy of approximately €5.80 must be paid for registration of the change of registry data. Transfer of the ownership of some kinds of tangible property (real property, motor vehicles, etc) should also be registered in the official register for an established registry fee that may amount to a maximum of €1,448.10, depending mostly on the type and value of the acquired property.

Regarding VAT taxation of the acquisition of stock or business, please refer to question 1.

### 7 Net operating losses, other tax attributes and insolvency proceedings

#### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

In a purchase of stock, the losses of the target will be carried forward to the following fiscal year according to the ordinary rules prescribed by the Law on CIT. Losses for the tax period, except for the losses incurred as a result of transferring the securities and derivative financial instruments, may be carried forward for an unlimited period. However such carry-forward shall be terminated if the entity ceases the activities due to which the losses were incurred, except where the entity ceases the activities for reasons beyond its control. Losses incurred as a result of transferring the securities and derivative financial instruments may be carried forward for no more than five consecutive tax periods and can only be covered by the income received from the transfer of securities and derivative financial instruments.

The Law on CIT provides a special regime for carrying forward losses in reorganisations or transfers corresponding to its requirements (see question 4). Under the Law on CIT, the acquiring entity continuing the activity taken over, or a part thereof, for a period not shorter than three years, may carry forward the losses of the acquired or transferring entity or entities (except for losses resulting from transfer of securities and from derivative financial instruments) related to the transferred activity incurred before the completion of the reorganisation or transfer and not carried forward to the following year.

From the tax period of 2014 and subsequent tax periods, the transfer of the amount of deductible tax losses, except the small companies, may not exceed 70 per cent of the taxpayer's income from the tax period, calculated as the income minus tax-exempt income, allowable deductions and limited allowable deductions, with the exception of tax losses from the previous tax year carried forward. This limitation is not applied in the case of losses incurred as a result of transferring the securities and derivative financial instruments because these losses may be carried forward for a limited period and can be covered only by the income received from the same activities.

Change of control of the target as such should not affect the tax credits of the target or other taxes deferred by the Law on CIT. Still, it should be noted that on application for the tax credit, the taxpayer must submit to the Tax Inspectorate information on the current composition of shareholders and planned changes, if any. Although the composition of shareholders should not directly affect the possibility of getting the tax credit or properly executing the received one, every case of tax credit is considered individually, thus information on shareholders might be important while evaluating the reliability and credit solvency of the taxpayer.

After the court decision to institute bankruptcy proceedings to the company becomes effective, and if the company is not able to further implement the unexpired contracts, such contracts are deemed to have expired, and claims of the creditors arising by reason thereof are met according to the ordinary procedures specified by the Enterprise Bankruptcy Law of the Republic of Lithuania. Thus, in such a case the tax credits or other types of deferred tax asset of the company being bankrupt, shall not be preserved and shall be recovered by the state as a creditor of the company.

Lithuanian tax laws do not provide any special rules or regimes for the taxation of acquisitions or reorganisations of bankrupt or insolvent companies, except for the provision of the Law on CIT and its official commentary stating that income received by the bankrupt Lithuanian company from the sale of its assets shall not be subject to the tax on corporate income. It should also be noted that according to the provisions of the Law on CIT, the same exemption should be applied to the income of a bankrupt foreign company received through its permanent establishment in Lithuania. Unfortunately, practice on this question is lacking and the position of the Tax Inspectorate is controversial.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

According to the tax laws, the interest on borrowings to acquire the target does not constitute a part of the target's price. The interest payments on loans taken by the Lithuanian company to finance the acquisition might, however, be treated as allowable deductions for corporate income tax purposes. The tax laws also provide a few restrictions on the deductibility of interest payments where the lender is foreign or a related person.

Subject to the Law on CIT, payments to the lender organised in the target territory can be treated as allowable deductions for calculation of tax on corporate income only if the paying Lithuanian entity or permanent establishment supplies the Tax Administration with evidence that such payments are related to the usual activities of the paying and receiving entities, the receiving foreign entity controls the assets needed to perform such usual activities and there exists a link between the payment and the economically reasonable operation.

The possibility of deducting interest for the loan received from the controlled party is restricted by reference to 'thin capitalisation' rules. Lithuanian thin capitalisation rules apply only to the extent to which the ratio between the capital borrowed from the controlling creditor and the fixed (equity) capital of the Lithuanian company (debtor) exceeds 4:1. The interest for the part of the loan exceeding the above-mentioned ratio cannot be deducted from the taxable income of the debtor, unless the debtor proves that the same loan could be provided or received on the same conditions between unrelated persons.

Finally, the interest on other loans received from related parties, even if not falling under thin capitalisation rules, must still comply with the arm's-length principle. Otherwise, the Tax Inspectorate is able to recalculate the taxable profits of the Lithuanian company (borrower) engaged in the transaction.

Lithuanian withholding taxes on interest payments can be avoided only by using the tax exemptions prescribed by the Law on CIT (see question 13).

Debt pushdown can be achieved only by having the consent of the creditor and of other shareholders of the target company.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Because the area of taxation is quite sensitive and risky, all possible forms of protection of the acquirer with respect to the target's fulfilment of its tax obligations for previous periods are recommended. Usually the representations and warranties of the seller regarding the proper fulfilment of all of its or the target's tax obligations are primarily related to the acquisition price of stock or business assets; if it becomes clear that these representations and warranties do not correspond to the real situation, the purchase price is accordingly decreased or the agreement on acquisition may be terminated. As an additional warranty, the payment of a part of the acquisition price may be postponed for the period during which potential risks are expected to arise or disappear. In a stock acquisition, it is always recommended for the acquirer to get official confirmation from the tax, social security and customs authorities proving the proper and complete settlement of the target with the appropriate institution.

Depending on the particular circumstances and selected strategy, the warranty measures may constitute a part of the sale-purchase agreement, its annex or may be written in separate documents.

Following a claim under a warranty or indemnity, compensation for losses or payment of forfeit (fines or penalties for delay) is usually received.

The compensation of losses or forfeit received by a foreign legal entity that has no permanent establishment in Lithuania is not treated as sourced in Lithuania and therefore is not subject to Lithuanian tax on corporate income.

In general, the compensation for losses, including received related insurance benefits, that is not in excess of the value of losses or damages actually incurred and that is received by a Lithuanian or by a foreign entity through its permanent establishment in Lithuania, is exempt from tax on corporate income in Lithuania. However, all expenses attributed to the said non-taxable income shall be treated as non-allowable deductions for the purpose of the calculation of tax on corporate income.

The forfeit received by the local company or foreign entity through its permanent establishment in Lithuania is treated as non-taxable income except in cases where the forfeit is received from a foreign entity registered or otherwise organised in target (tax haven) territory or from a natural person being the resident of such territory.

It should also be noted that compensation for the damages caused or forfeit paid for the breach of the agreement is treated as non-allowable deductions of the payer and therefore they cannot be deducted from taxable income of the default party.

According to the Law on VAT, the forfeit and other similar sums are not treated as remuneration for goods or services and therefore are not subject to VAT in Lithuania.



## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

The post-acquisition restructuring depends on many aspects, such as the objectives of the acquisition, current or planned activities and the structure of the group to which the acquirer belongs. Restructuring is usually intended to increase the effectiveness of the acquired business and to integrate it into the acquirer's team. It usually starts from a review of financial flows and labour resources.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

The Law on CIT provides for a few cases of tax neutral spin-offs of businesses. Pursuant to it, the participants in a tax neutral spin-off must be Lithuanian companies, or foreign companies – tax residents in other EU member states, continuing the acquired activities through permanent residence in Lithuania after the spin-off is executed. Additionally, the conditions of the spin-off must satisfy the following legal requirements:

- (i) a company, on being dissolved through a reorganisation, divides all its assets, rights and obligations into a few parts and transfers them to a few existing or new companies. As a result, the members of the divided company, in exchange for the shares held in it, receive pro rata shares issued by the acquiring entity;
- (ii) a company, continuing its activity, transfers one or a few parts of its activity constituting an independent unit able to engage in commercial activity, to one or a few existing or new companies. This results in a decrease of the transferring company's authorised capital and the members of the transferring company, in exchange for the shares held in it, receive pro rata shares issued by the receiving companies;
- (iii) a company, continuing its activity, transfers all its activity or one or a few parts thereof to another company in exchange for the shares of the receiving company; or
- (iv) a company, continuing its activity, divides proportionally a part of its assets, equity and obligations, and based on the divided part one or a few new companies are established.

The capital gains resulting from the spin-off of business corresponding to the specific requirements above are exempted from taxes on profit on the condition that the shares acquired during the spin-offs indicated in points (i) to (iii) are not disposed of for three years.

The acquiring entity, continuing the activity taken over, or a part thereof, for a period not shorter than three years, may carry forward the losses of the transferring entity (except for the losses resulting from transfer of securities and derivative financial instruments) related to the transferred activity and incurred before the completion of the reorganisation or transfer. From the tax period of 2014 and subsequent tax periods the transfer of the amount of deductible tax losses except the small companies may not exceed 70 per cent of the taxpayer's income of the tax period, calculated the income minus tax-exempt income, allowable deductions and limited allowable deductions, with the exception of tax losses of the previous tax year carried forward. This limitation is not applied in the case of losses incurred as a result of transferring the securities and derivative financial instruments because these losses may be carried forward for a limited period and can be covered only by the income received from the same activities.

Depending on the substance and form of the spin-off, the transfer of assets may be subject to VAT. As mentioned in question 1, if the spin-off is not executed through the reorganisation and the transferee continues the acquired activity, the transfer of whole or a part of business, as a complex unit of rights and obligations, including cases where whole or a part of business, as a complex, is transferred as a contribution of a member of the legal person, shall not be taxable by VAT.

If the division of a part of business is executed as a special type of reorganisation corresponding to the requirements of the Law on Companies, during which the transferor is ending its activities or if the assets, not comprising whole or a part of the business as a complex

entity, are transferred as a contribution to the capital of legal entity, the transfer of the assets shall be subject to VAT provided that the purchase or import VAT from the particular property or business activity was deducted by the transferor.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

The Law on CIT provides the possibility to migrate residence from Lithuania to another EU member state only for European companies or European cooperative societies. In such cases the capital gains shall not be treated as taxable income in Lithuania and the losses of the former Lithuanian company may be carried forward by the foreign company. The mentioned exemptions will be applied provided that, following the transfer of its registered office to another EU member state, the company continues to carry out its activities through a permanent establishment in Lithuania on the basis of the assets, rights and obligations formerly attributed to the Lithuanian company.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Pursuant to the Law on CIT, the interest and the dividends paid by a Lithuanian company to a non-resident company are in general subject to Lithuanian withholding tax on corporate income. In general, interest is taxable at 10 per cent and dividends at 15 per cent.

Still, interest paid to a foreign legal person registered or otherwise organised within a member state of the EEA or within a state that has and applies a treaty on the avoidance of double taxation with Lithuania is exempt from withholding tax on corporate income in Lithuania. In addition, interest paid to a foreign legal person on securities issued by the government on international financial markets, interest accrued and paid on deposits and interest on subordinated loans that meet the criteria set down by the legal acts of the Bank of Lithuania is also not subject to Lithuanian withholding tax.

Regarding exemptions for taxation of dividends, the dividends paid out to a foreign company that is not organised in a target (tax haven) territory and that uninterruptedly for at least 12 months controls not less than 10 per cent of voting shares in a Lithuanian company shall not be subject to taxation in Lithuania (participation exemption).

The exemptions provided for in the national legislation are also applicable when the treaty on avoidance of double taxation provides a less favourable regime. If the treaty on avoidance of double taxation provides a more favourable regime, the provisions of this treaty should be followed and the lower tax rate should be applied.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Because of exemptions available for the taxation of interest (see question 13), the payment of interest for loans received from the shareholder is a quite popular way for extracting profits. However, this possibility is restricted by thin capitalisation rules and the arm's-length principle (see question 8).

Payment of dividends is used for extracting profits mostly where the recipient is able to profit from the tax exemptions in Lithuania (see question 13), taking into consideration the taxation of dividends in the home country of the recipient.

Decrease of the authorised capital of the company and payment of the released funds to the shareholders is also tax-free, if the part of the authorised capital being reduced previously was formed by the contributions of the shareholders. Otherwise the sums paid out to the shareholders as a result of a decrease of the authorised capital shall be treated as dividends and shall be subject to taxation at the ordinary rates, taking into consideration the participation exemption (see question 13).

For quite a long time, owing to the different taxation of dividends and bonuses to management or supervisory board members paid out



## Update and trends

On 31 May 2018, Lithuania joined the OECD. Since Lithuania started negotiations to join OECD there have been some changes in treatment to comply with the base erosion and profit shifting recommendation package. Although Lithuania's economics growth is one of the fastest among OECD countries, many changes must occur in the future. The following steps have been taken and these are the latest updates.

### Social insurance taxes will be paid by the insured person

A year ago, a new Labour Code came into effect and it was the first step in making the Lithuanian labour market more liberal. The latest changes have been made to make it even more innovative and attractive to investors – duty to pay social insurance taxes has been transferred to employee. Until now social insurance taxes were paid by employer. On the other hand, every current employment contract must be changed. The law has obligated wages to rise for all employees by 1.289 (gross) times before the new regulation comes into effect. Effectively, the amount of money that an employee will get mostly will be the same. Yet after the new regulation comes into effect the burden of paying social insurance taxes will be taken off employers. This will mean employees will manage to get higher wages (gross) and it should help fight tax evasion.

### New data protection requirements

On 25 May 2018, Data Protection Directive 95/46/EC (Directive) was replaced by the General Data Protection Regulation (GDPR). GDPR is directly applicable in each member state of the EU, including Lithuania. Related to these changes, the new wording of the Republic of Lithuania's Law on Legal Protection of Personal Data came into effect on 16 July. In the light of GDPR, investors should review and decide the location for information used by their tax and accounting team to ensure tax and accounting solutions are GDPR compliant. In the case of mismatches, the State Data Protection Inspectorate may set fines (up to 4 per cent of the total worldwide annual turnover of the preceding financial year depending on the mismatch).

### Taxable profits may now be reduced by 100 per cent in the case of investment projects

The highest percentage reduction on taxable profits used to be 50. To be eligible for the new 100 per cent relief, an entity has to purchase new assets to start new activities or expand current ones. The costs incurred during these acquisitions can be used to reduce taxable profits. Assets purchased cannot be older than five years and must be used for at least three years. The period in accordance with the procedure was extended by five years – until 2023. Thanks to these amendments, the environment for investing in Lithuania should become more attractive. This kind of taxable profits reduction is also flexible – where the amount of costs incurred exceeds the amount of taxable profits calculated for a tax period, the costs exceeding this amount may be carried forward to reduce the amounts of taxable profits calculated for the four subsequent tax periods, respectively reducing the amount of the costs carried forward.

### Taking steps towards cooperation between science and business

By adopting the new Technology and Innovations Law Lithuania began a reform of innovations. The aim of the reform is cooperation between business and science. The new law determines institutions' responsibilities for reaching common aim – more innovative business. A host of institutions is being created to work on the matter – to prepare a model of financial and intellectual assistance for both sides. The

provisions of the law make prerequisites for the establishment of a state innovation promotion fund that will provide support to science and study institutions and innovative businesses, and promote their sustainable cooperation.

### Following OECD recommendations

After the 2018 OECD Economic survey on Lithuania, one of the recommendations was to raise immovable property taxes but exempting low-income workers. The current situation is that basically vast majority of immovable property is not taxed. Zero per cent tariff relief is granted to all immovable property under €220,000 (if the property is above this amount the tariff is 0.5 per cent). In the light of OECD recommendations, taxes were raised for properties whose value exceeds €300,000 and €500,000, respectively to tariffs of 1 per cent and 2 per cent.

### Changes in tax administration

Right to information: the tax administrator has a right to get information from entities about their assets, profit, expenses and activities. This right was extended – now the tax administrator can demand information not only from entities but also from a direct beneficiary. It means that the owner of the entity has a duty to comply with the tax administrator's demands concerning information about his or her assets, profit, expenses and activities.

Right to review and recalculate taxes: the period of time in which the tax administrator has a right to review taxes was shortened to three years (it used to be five). However, in some cases (eg, personal income tax, VAT payments) the period for rechecking could be lengthened to five or 10 years.

These amendments will come into effect on 1 January 2020.

### Changes in liability regulation

If tax evasion is ascertained during a tax inspection, then between 10 per cent and 50 per cent of the amount of tax that the subject was trying to avoid will be set as a fine (current order). A new regulation has added stricter liability for those who cannot justify concealing income, and are aiming to avoid tax. In this case the fine would be calculated at between 50 per cent and 100 per cent of the amount of unpaid taxes. A further rule applies to both liabilities – if the offence reoccurs repeatedly during the past five years, then the fine is doubled.

In the case of a false declaration of a submission to the tax administrator about profit, income or assets, when performed intentionally seeking to avoid taxes (the amount of taxes that has to be paid does not exceed €5,000) – liability has become stricter. For this kind of violation the fine used to be between €150 and €600; currently the fine would be from €500 to €6,000.

### Trends

#### Potential government plans for 2019

According to the government, the innovation reform plan will be one of the major aims for 2019 and beyond. Planned steps are in effect and during coming years states' donation policy towards innovations will be relooked and new priorities formed. New priorities should lead to a new financial instrument to establish an infrastructure of technological centres. A new 'post-investment services' strategy will then be set up for inbound investors. It has not been specified what the strategy will include. However, the aim of the innovation reform is to attract investment, thus reliefs and support for investors may well be considered as options.

to natural persons (dividends were taxed at 20 per cent and bonuses at 15 per cent tax on personal income), bonuses were sometimes preferred. However, from 1 January 2014, both dividends and bonuses paid out to natural persons are taxed at 15 per cent on personal income, and therefore the tax advantage of bonuses is lost.

Purchase of services from the shareholder may also be used as a device to extract profits. However, the services must be necessary for the activities of the daughter company, they must be provided in fact and the arm's-length principle with respect to the price for the services must be followed.

## Disposals (from the seller's perspective)

### 15 Disposals

#### How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

The manner of disposal depends on the particular situation and needs of the parties (preserving confidentiality, minimising taxes or other expenses, meeting deadlines, etc).

In general, capital gains received by a Lithuanian company on the disposal of business assets and stock are taxed at the same rate of tax on corporate income (currently 15 per cent). Still, in the event of disposal of stock, the Lithuanian company could benefit from the participation exemption for capital gains resulting from the transfer of stock of a company. To meet this kind of exemption a company must

be registered or otherwise organised in a state of the EEA or in a state with which a treaty for the avoidance of double taxation has been concluded and is applied, and which is a payer of corporate income tax or an equivalent tax if:

- the company transferring the shares held more than 10 per cent of the voting shares in the transferred entity for an uninterrupted period of at least two years; or
- the shares are transferred during a tax-exempt reorganisation or transfer and the transferor held more than 10 per cent of the voting shares in the transferred company for an uninterrupted period of at least three years.

Capital gains of the foreign company on transfer of stock and on transfer of business assets in general are not treated as sourced in Lithuania and therefore are not subject to Lithuanian tax on corporate income, except for the income received from the transfer of ownership to the immoveable property located in Lithuania.

For VAT on the disposal of stock and business assets, see question 1.

## 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Capital gains of a foreign company on transfer of stock are not treated as sourced in Lithuania and therefore are not subject to Lithuanian tax on corporate income.

Lithuanian laws do not provide for special rules dealing with the disposal of stock in real property, energy or natural resource companies.

## 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

If the gain subject to taxation in Lithuania is received by the foreign company, the tax on corporate income must be deducted and transferred to the budget of Lithuania no later than 15 days after the end of the month during which the income was paid out. If the gain is received by the Lithuanian company, the tax on corporate income must be paid before the first day of the sixth month of the next tax year.



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# Malta

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Asset and share purchases have different tax consequences for the purchaser. An asset deal generally presents advantages as the tax depreciation is calculated on the amounts at which assets are acquired, avoiding the need to undertake extensive due diligence regarding the assets, liabilities and obligations inherent in acquiring a company. An advantage of an asset purchase over a share purchase is that the tax cost base of depreciable assets may increase and new intangible assets (eg, intellectual property rights internally generated by the target) may be created on which the acquiring company may claim tax deductions. Where a purchase of assets is financed by debt, the interest expense is incurred by and deductible for the operating company, thus ensuring that it is immediately utilised against operating profits. Where a purchase of assets is financed by equity, a notional interest deduction should be available for the operating company (various conditions apply).

Advantages of asset purchases are outlined as follows:

- an unrelated purchaser can claim tax depreciation and other tax deductions based on the cost at which the assets were acquired. Such assets may include intangible assets generated by the seller that would not be recorded on the book of the target;
- an asset purchase is ideal when acquiring a part of a business or upon the non-acquiring of core business and assets, thus avoiding a split of the target prior to a share purchase deal;
- in an asset purchase deal, the purchaser does not acquire the target along with its liabilities and obligations (some of which could be unknown or contingent);
- interest incurred to finance an asset purchase is deductible against the operating income generated from the business or assets acquired, thus avoiding the need for debt pushdown planning at a later stage; and
- a step-up in the cost base of assets for tax purposes is obtained.

Disadvantages of asset purchases are outlined as follows:

- a possible need to renegotiate supply, employment and technology agreements;
- a higher capital outlay is usually involved (unless debts of the business are also assumed);
- unutilised tax losses and depreciation are not taken over;
- where an asset purchase deal results in higher tax for the seller, the purchase price may be higher;
- the purchaser may need to reapply for licences; and
- higher transfer duties may apply, especially in the case of real estate.

Advantages of share purchases are outlined as follows:

- usually involves a lower capital outlay (in purchase of net assets only);
- purchaser normally benefits from unutilised tax depreciation and tax losses; and
- contractual continuity, as there is only a shareholding change in the target, which avoids the need to renegotiate contracts.

Disadvantages of share purchases are outlined as follows:

- buyer effectively becomes liable for any claims or previous liabilities of the entity (including tax);
- buyer misses out on potentially higher depreciable asset values in an asset purchase deal;
- if debt-financed, interest expense is not immediately deductible against operating profits of target but only against dividends with the right refund of underlying tax, creating cash flow disadvantage and thus a need for debt pushdown strategies (eg, merger of target with acquisition company); and
- where an exemption from transfer and document duty is not available, additional duty on the value of the shares may be incurred.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In principle, the purchase of assets may increase the cost base for the buyer (while a gain from the sale is taxable for the seller). However, Maltese tax law only imposes a tax on transfers of certain prescribed capital assets and the transfer in whole or in part of a business, but not a general capital gains tax. For tax purposes, it is necessary to apportion the total consideration among the assets acquired. Where the purchase agreement specifically stipulates the purchase price for each asset acquired, the allocation generally is accepted for tax purposes. Although Malta does not have transfer pricing legislation, the amounts stipulated in the purchase agreement should approximate fair value in accordance with International Financial Reporting Standards (IFRS), as the IFRS accounting values are generally recognised for tax purposes. Certain intangibles such as intellectual property can be amortised for tax purposes in the event of their acquisition, while if the company is acquired such assets will continue to be amortised in a seamless manner. Where a transfer of assets takes place pursuant to a merger or division under the terms of the Companies Act, the acquiring company succeeds to all the assets, rights, liabilities and obligations of the companies being acquired, including any domestic unutilised tax depreciation and tax losses. In other acquisitions and share exchange transactions, unutilised tax depreciation and tax losses cannot be transferred between different legal entities.

On a share deal, the tax base cost of the assets of the target company remain unchanged. The acquiring company generally inherits unutilised tax depreciation and tax losses. However, where the shares in a company are acquired solely or mainly for the purpose of acquiring a tax advantage, unutilised tax depreciation and tax losses may be lost.

A company resulting from a cross-border merger in Malta, which merger is governed by the Cross-Border Mergers of Limited Liability Companies Regulations, is entitled to claim a step-up in the tax base cost of assets situated outside Malta without any adverse Malta tax consequences. Such a company may opt, for Malta tax purposes, to revalue the assets from historical costs to fair market value at the time of continuation to Malta provided that none of the assets owned by the company on the day of the merger was owned by any merging company that is domiciled or resident in Malta at any time prior to the date of the

particular merger. The revaluation will apply for the purpose of determining gains on a subsequent disposal of the assets. Such a step-up may also be available upon a change in domicile or residence to Malta.

### 3 Domicile of acquisition company

#### **Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Several potential acquisition vehicles are available for achieving a merger or acquisition. The tax implications ultimately influence the choice of vehicle.

A Maltese holding company is taxed as an ordinary company at the standard corporate tax rate of 35 per cent. However, under Malta's imputation tax system, no tax is payable on dividends received from resident companies. Moreover, on the receipt of dividends from other resident companies, the holding company may claim tax refunds, which generally reduce the Maltese tax to between zero and 6.25 per cent. These tax refunds may also arise as a consequence of debt financing as the interest expense is deductible against dividends received, thus releasing all or part of the underlying tax on the dividends as a tax refund. Where certain conditions are met (ie, 5 per cent holding), a participation exemption should apply to any income derived from non-resident companies and to gains arising from the disposal of shares in resident and non-resident companies.

Where Malta is chosen as the domicile of an acquisition vehicle that will acquire non-resident companies, it is beneficial to use a company not domiciled (incorporated) in Malta but resident in Malta by virtue of the exercise of central management and control (effective management) in Malta. Such a company is only subject to Maltese tax on Maltese source income and gains and on foreign income actually received in Malta; the company is not taxed on foreign source capital gains even if received in Malta. Such a company may thus benefit from Malta's network of tax treaties.

The use of a foreign company as the acquisition vehicle does not create any advantages or disadvantages from a Maltese tax perspective. The foreign company is entitled to any dividends, interest or royalties without any Maltese withholding tax. The foreign company is also entitled to tax refunds paid by operating distributing companies in the same way as a Maltese holding company, thus reducing the Maltese tax liability to between zero and 6.25 per cent. However, the receipt of dividends and tax refunds by the foreign company may expose it to tax on the dividend or tax refund in its country of residence. The use of a foreign company may create a tax advantage in cases where the Maltese company owns Maltese immovable property and the treaty between Malta and the foreign jurisdiction restricts the taxing rights of Malta. However, Malta upon signing the Multilateral Instrument has opted to change the provision of these treaties and this should be considered in more detail.

Joint ventures do not have a specific legal form under Maltese law and can be conducted through partnerships, limited liability companies or contractually. Where a legal form is not established or a partnership (that does not opt to be treated as a company) is established, the partners are generally assessed on their share of the profit of the joint venture. The partnership may elect to be treated as a company, thereby allowing the application of the tax refund system, reducing the Maltese tax burden to between 0 and 6.25 per cent.

### 4 Company mergers and share exchanges

#### **Are company mergers or share exchanges common forms of acquisition?**

Mergers and share exchanges are a common occurrence, with tax law facilitating such reorganisations and company law regulating the amalgamation or merger of companies. In summary, an amalgamation or merger is the process whereby a company (the acquiring company) acquires all the assets, liabilities, rights and obligations of another company (the company being acquired) in consideration for the issue by the acquiring company of shares to the shareholders of the company being acquired, plus a cash payment not exceeding 10 per cent of the nominal value of the shares issued. The acquiring company may either be an existing company or a new company incorporated as part of the merger process. The company or companies so acquired then cease to exist by

operation of law without having to be wound up. Through the application of the implemented EU company law Merger Directive, mergers (and division) of companies may also be carried out cross-border with companies incorporated in other EU member states. The general rule is that the company law procedure that is usually followed in a cross-border merger is the company law of the country in which the resultant company or companies (acquiring company or recipient companies) will remain.

### 5 Tax benefits in issuing stock

#### **Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

There is no tax benefit to the acquirer in issuing stock as consideration rather than cash per se, other than the transfer qualifying as a reorganisation under company law and thus also for tax purposes where no loss or gain is deemed to have arisen from such transfer with said exemption, however, only available where the exchange of the shares does not produce any change in the individual direct or indirect beneficial owners of the companies involved or in the proportion in the value of each of the companies involved represented by the shares owned beneficially directly or indirectly by each such individual. In cases when the Maltese target company is issuing shares in exchange for a no cash consideration, company law generally requires a valuation report from an expert (auditor) to ensure the proper valuation of the issued shares with an intention to protect the company's creditors. Issuing stock could also increase the risk capital of the acquirer and increase the entitlement of the acquirer to a notional interest deduction.

### 6 Transaction taxes

#### **Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

Where the acquisition involves the transfer of immovable property or shares in companies having 75 per cent or more of the value of fixed assets being Maltese immovable property, a duty of 5 per cent is normally payable unless the immovable property group exemption applies. Further, where the acquisition involves the transfer of shares, a duty of 2 per cent may be payable unless one of the numerous exemptions apply. The duty is payable on the higher of the consideration or market value. In practice and in accordance with the Civil Code, the purchaser normally pays the duty. However, the law provides that the seller and the purchaser are jointly and severally liable for the payment of the duty.

If the seller has charged VAT on the asset transfer, the purchaser may or may not be able to recover the VAT, depending on the nature of the purchaser's business, but a transfer of a going concern would fall outside the scope of VAT.

### 7 Net operating losses, other tax attributes and insolvency proceedings

#### **Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Under previous Inland Revenue practice, unutilised losses or capital allowances of a merging entity were generally preserved and consolidated at the level of the acquiring entity. As from year of assessment 2017, losses of a company can only be availed of by another company, other than by way of group loss relief, if a ruling under the Rulings (Income Tax and Duty Treatment of Mergers and Divisions) Rules is successfully procured from the Commissioner of Inland Revenue (subject to a commercial bona fide justification being in place).



## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Maltese tax law provides for the deductibility of interest incurred on money borrowed, provided that the interest is payable on capital employed in acquiring income. This deduction rule has the following implications for the purchaser:

In an asset purchase deal partly or wholly financed by debt, the acquisition vehicle acquires the business or business assets and becomes the operating entity, in which case the interest expense is deductible against income derived from the business or business assets.

In a share purchase deal partly or wholly financed by debt, the acquisition vehicle acquires shares in a Maltese operating company or companies. Whichever acquisition vehicle is used, the relative interest expense is not deductible against the profits of the Maltese operating companies but is tax-deductible against dividends received by the acquisition vehicle from the operating companies. As a result of this deduction, the Maltese underlying tax attaching to the dividends received is wholly (where the interest expense is equal to or exceeds the dividend received) or partially refunded. Any interest expense in excess of dividends received does not constitute a tax and is lost. For these reasons, it is normally beneficial to merge the acquisition vehicle with the operating company or companies so the operating companies can deduct the interest expense. Also, as a result of the tax refund system, the Maltese tax on distributed profits after the deduction of interest expenses would range between zero and 6.25 per cent.

Malta does not currently have any thin capitalisation rules, so there is no limit on the amount of debt financing. However, the Anti-Tax Avoidance Directive (2016/1164; ATAD) provides for interest limitation rules that should limit net interest expense deductions to 30 per cent of the EBITDA of a Maltese entity being taxable as a company (there are a number of exceptions such as deducting exceeding borrowing costs up to €3 million, which Malta is likely to opt for). At the time of writing, the date of the implementation of this interest limitation rule is unclear. Further, Malta does not have transfer pricing rules, although a general anti-avoidance provision may apply in certain circumstances. Under Maltese tax legislation, interest paid to a non-resident is not subject to tax (by withholding or otherwise), provided that the debt claim in respect of which the interest is paid is not effectively connected with a permanent establishment of the non-resident in Malta.

Notional interest deduction (NID) was introduced on 5 October 2017 and came into force with effect from year of assessment 2018. NID was introduced to achieve an equal treatment of debt and equity financing, by granting an additional deduction for the return on equity financing. In addition, the NID may simplify matters within Malta's full imputation system in view of the resulting reduction in the imputation credits resulting from claiming the NID.

The NID is optional and can be claimed by companies and partnerships resident in Malta (including Maltese permanent establishments of foreign entities) against their chargeable income for the year. The NID is calculated by multiplying the deemed notional interest rate by the balance of risk capital that the undertaking has at year end. The notional interest rate is the risk free rate set on Malta Government Stocks with a remaining term of approximately 20 (which is currently approximately 2 per cent) years plus a premium of 5 per cent. The NID would thus currently be expected to be about 7 per cent. Risk capital includes share capital, share premium, reserves, interest free loans and any other item that is shown as equity in the financial statements as at year end excluding risk capital employed in the production of exempt income. The maximum deduction in any given year cannot exceed 90 per cent of chargeable income before deducting the NID. Any excess can then be carried forward to the following year. Any remaining chargeable income is subject to tax at the standard rates. When a company or partnership claims a NID, the shareholder or partner is deemed (for tax purposes) to have received the corresponding notional interest income from the company or partnership. Distribution of profits relieved from tax by the NID, however, will not be charged to tax. The

### Update and trends

Malta is committed to continuing and extending its role as a major European financial centre, ensuring at the same time transparency and compatibility with EU laws. Discussions have started on the implementation of the Anti-Tax Avoidance Directive 2 (2017/952) into Maltese legislation. The government of Malta has developed a broad national strategy that will see the government embracing blockchain innovation.

legislation includes an anti-abuse provision to prevent abuses of the NID.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Stock and business asset acquisitions may be protected by agreement between the parties under warranties, indemnities and tax warranties, generally included in the share purchase and asset purchase agreements.

Subject to the terms of the sale-purchase agreement, an amount received or payment pursuant to warranty provisions is normally regarded as capital in nature and constitutes an adjustment to the agreed purchase price.

### Post-acquisition planning

#### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

In a share purchase deal, it is normally beneficial to merge the acquisition vehicle with the operating company or companies so the operating companies can deduct the interest expense (debt pushdown).

#### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Tax neutral spin-offs can be achieved by a division of a company into two or more companies as follows:

- by acquisition, whereby a company transfers all its assets and liabilities to two or more existing companies in exchange for the issue, to the shareholders of the company being divided, of shares in the recipient companies and a cash payment, if any, not exceeding 10 per cent of the nominal value of the shares so issued; or
- by formation of new companies, whereby new companies are formed for the purposes of acquiring the assets and liabilities of the company being divided and the shareholders of the company being divided are issued shares in the newly formed companies and a cash payment, if any, not exceeding 10 per cent of the nominal value of the shares so issued.

The transfer of shares upon a division, where the company being divided and the recipient companies form part of the same group, should be exempt from stamp duty. Furthermore, no gain or loss will be deemed to arise on the transfer of assets by the company being divided to the recipient companies upon a division where the companies form part of the same group.

Companies involved in a merger or division may apply to the Commissioner for Revenue to rule that no Malta tax or duty on documents is payable in respect of any transaction or transactions carried out in the course of the merger or division. The Commissioner for Revenue may issue such a ruling if he or she is satisfied that the transaction or transactions are to be effected for bona fide commercial reasons and do not form part of a scheme or arrangement of which the main

purpose, or one of the main purposes, is avoidance of liability for duty or tax.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

It is currently possible to migrate the tax residence and real seat of the acquisitions or target company from Malta without tax consequences. However, in view of ATAD from 1 January 2020, Malta will have to introduce exit taxation in case of transfer of tax residence (ATAD provides for tax deferral in certain specific cases). Any Maltese company may be re-domiciled (continued) out of Malta to a foreign jurisdiction that has legislation allowing the continuation of companies in and out of that jurisdiction.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Malta does not levy any withholding taxes on dividends and interest.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Given Malta's imputation and tax refund system, in the vast majority of cases, it is normally beneficial for the seller to realise part of its value in the target by paying dividends or simply declaring them, which creates a liability for the target. The payment normally results in no further tax. The seller may also be entitled to claim tax refunds (normally, six-sevenths of the 35 per cent Malta tax charge) from the Maltese tax authorities and the sales proceeds may be correspondingly reduced.

In view of the lack of withholding taxes, transfer pricing and thin capitalisation there is no need for other tax-efficient means for profit extraction, but depending on the other jurisdiction there are additional alternatives (reduction of share capital, liquidation).

## Disposals (from the seller's perspective)

### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Disposals are usually carried out by a disposal of stock in the local company, where if such company does not qualify as a real estate company (holding Maltese immovable property) such transfer would qualify for a participation exemption.

Where the seller is a company resident in Malta (by virtue of central management and control) but not domiciled (incorporated) in Malta and the transfer comprises capital assets (business or shares and other assets) not situated in Malta, no exposure to Maltese tax arises. Such a resident non-domiciled company is only taxable on its Maltese source income or capital gains and on foreign-source income that is actually received in Malta.

On the other hand, a transfer of a business or business assets is normally subject to capital gains tax at the rate of 35 per cent. However, the effective tax suffered in Malta may be reduced to 5 per cent under Malta's full imputation and tax refund system on profit distributions.

Tax law also provides for a deferral of tax where assets are transferred between companies that are deemed to be a 'group of companies' for tax law purposes. A 'group of companies' is defined to include companies that are controlled and beneficially owned directly or indirectly as to more than 50 per cent by the same shareholders. This is further qualified for intragroup transfers of immovable property situated in Malta or securities in a property company (essentially defined as a company that owns immovable property in Malta, directly or indirectly, through its shareholdings in other bodies of persons). In this case, the ultimate beneficial shareholders of the transferor and transferee companies must be substantially the same, with only a 20 per cent variance in each individual's shareholding in the two companies. Where the applicable conditions are met, no loss or gain is deemed to have arisen from the transfer. The cost base of the assets does not increase for tax purposes, but the tax on the capital gain is deferred until a subsequent transfer outside the group.

As Malta has fully implemented the EU Merger Directive (90/434/EEC), qualifying cross-border mergers that do not meet the conditions above could secure tax-neutrality where they meet the Directive's stipulations.

### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Disposal of stock in a local company by a non-resident company not held by Maltese interests is exempt from tax. Where disposal consists of stock in a real property company (with such property being limited to Maltese real estate and interests therein) a seller would be subject to tax.

### 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

A tax-free rollover regime is available on the transfer of business assets as explained under share disposal, where assets are transferred between companies that are deemed to be a 'group of companies' for



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In addition, a tax-free rollover regime is available on other assets, where a taxable asset that has been used in a business for a period of at least three years is transferred and replaced within one year by an asset used solely for a similar purpose in the business, any capital gain realised on the transfer is not subject to tax, but the cost of acquisition of the new asset is reduced by the amount of the gain. When the asset is eventually disposed of without being replaced, the overall gain must take into account the proceeds of the transfer, and the cost of acquisition reduced as explained above. If the capital gain exceeds the cost of acquisition of the replacement property, the excess is taxable in the year in which the replacement property was acquired, and the cost of acquisition of the replacement property to be taken into account on a subsequent transfer is zero.

# Mexico

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

On a day-to-day basis, the acquisition of stock is one of the most frequently used alternatives to gain control of a target company. From a tax perspective, the acquisition of stock has many virtues; among them, the fact that the sale of stock in a company is generally not subject to value added tax or that tax attributes of the target company are included in the acquisition thereof.

As mentioned above, the acquisition of stock includes tax attributes. However, it should be noted that tax liabilities prior to the transfer of the business are also included therein, thus outlining the paramount importance of conducting thorough accounting, legal and tax due diligence. (For further details, see question 9.)

Notwithstanding the foregoing, certain aspects must be taken into account when opting for this alternative. For instance, in some cases where certain tax requirements are not met, tax consequences for a non-resident purchaser could be triggered. Income tax could be triggered in operations in which non-residents acquire stock issued by a Mexican resident when tax authorities determine that the market value thereof exceeds the purchase price by more than 10 per cent.

A common alternative to the acquisition of a target company via stock purchase is the acquisition of the business assets thereof. In general terms, this option consists of the purchase of the assets that are essential for the operation of the target company. In a sense, this alternative enables the acquirer to handpick the assets that are considered valuable and discard other items deemed as a burden for the business in question.

Moreover, tax authorities may permit certain authorised deductions in connection with the calculation of income tax due for the acquisition of the business assets. Nevertheless, it is important to point out that pursuant to applicable Mexican tax laws, goodwill may not be deducted.

Unlike acquisition of stock, the general rule is for acquisitions of business assets to be subject to value added tax, and, whenever real estate is involved in the operation at hand, federal and local taxes thereupon could be triggered.

Furthermore, in an asset deal, in terms of article 26(iv) of the Federal Tax Code, the acquirer could be jointly liable for contributions generated prior to the acquisition of the ongoing business for up to the value of the business itself (the full price paid for all the assets).

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In connection with the acquisition of stock, no step-up in basis is considered regarding assets of the target company; in general terms, the step-up in basis only occurs concerning the price paid for the purchased

stock. (The tax basis of the assets remains the same, thus, no step-up in basis could be deemed to exist.)

With reference to the acquisition of business assets, the basis for the acquisition will be the amount effectively paid therefor and allocated to each asset; hence, a step-up in the basis thereof could be considered.

Additionally, in the latter, both fixed assets and intangibles may be deducted through the straight-line method, bearing in mind that goodwill, among other items, may not be deducted for income tax purposes.

Other items, such as investments in fixed assets, cost and deferred charges, preoperative expenses, technical assistance and royalties may be deducted in the percentage set forth in the corresponding provisions for each item.

On 18 July 2017, an administrative decree permitting the immediate deduction of newly acquired fixed assets (for up to the percentages specified therein for each type of asset) by legal entities or individuals that perform business activities was issued. In this regard, it is worth noting that 2018 will likely be the last fiscal year in which taxpayers will be allowed to benefit from it.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

There are numerous aspects that must be carefully analysed in order to decide whether to acquire a target company directly (as a non-resident) or indirectly by means of a (Mexican) resident company.

In a stock deal, in cases where the purchase of the target company is made by the non-resident by means of a Mexican entity, the cost of the acquisition will be generated at the level of the first (ie, due to a capital increase in the resident company used for the purchase) and, indirectly, at the target company's level. From a tax standpoint, tax consequences deriving therefrom could be either adverse or beneficial depending on several factors (such as the target company's financial position in the relevant tax year).

Should the non-resident decide to perform the acquisition of the target company on its own, tax treaties executed by Mexico ought to be kept in mind given that certain benefits pertaining to the distribution of profits, capital gains, payments on interests, etc, from the target company to the purchaser could apply depending on the applicable tax treaty.

In an asset deal, if the acquiring entity resides abroad, a permanent establishment could be deemed to exist in cases where a non-resident acquires the essential assets directly and continues the operation thereof. Accordingly, the non-resident could be taxed over Mexican-sourced income and, in cases where a permanent establishment is deemed to exist, over income attributable thereto as well.

Regardless of the foregoing, other options such as special purpose vehicles could be considered in order to perform a tax-efficient acquisition, reducing exposure to liabilities.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

From a tax perspective, mergers (provided that both of the parties involved are Mexican residents for tax purposes) tend to be more



efficient than share exchanges. The foregoing is the case, given that mergers may be treated as tax-free transactions, provided that certain requirements are met. In that sense, it is common that mergers do not cause income tax or value added tax. (Exceptions may apply.)

Likewise, tax attributes of the merged company may be passed down to the surviving company. (Certain exceptions such as net operating losses may apply).

Pursuant to applicable Mexican tax laws, share exchanges are a tax-efficient alternative only to corporate restructures of entities of the same group, as any share exchanges could be considered as a double sale with the corresponding tax consequences (a taxable transaction for both parties).

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

From a corporate standpoint, the issuance of stock by the acquirer as consideration could prove to be a convenient strategy. Likewise, the convenience thereof could lie in cases where the acquirer has a cash shortage or cash flow-related complications.

Nonetheless, in general terms no tax benefit is included in the applicable Mexican tax laws with regard to this alternative. Thus, even in cases where the purchaser issuing the stock might not trigger tax consequences, the recipient thereof could in fact have to face tax repercussions similar to a cash deal.

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Mexican tax laws do not contain documentary taxes such as stamp duties in connection with the acquisition of stock or business assets. However, value added tax is due in the performance, either by individuals or legal entities, of certain activities. In this regard, and as mentioned in question 1, value added tax could be payable concerning asset operations (ie, asset purchase agreements) in which business assets are acquired (certain exceptions, such as account receivables, may apply).

According to the Mexican value added tax law, the general tax rate is of 16 per cent. The sale of certain goods may be subject to a rate of zero per cent or even exempted from the tax at hand.

In connection with operations and transactions carried out after the acquisition of a target company by means of an asset purchase agreement, distinguishing between activities subject to a zero per cent value added tax rate and those that are exempted thereof is vital given that, while the first may allow the crediting of paid value added tax, the latter do not give rise to such benefit.

In recent years, tax authorities have assumed an aggressive position towards value added tax refund claims, slowing down refund procedures, whereby legal action is often necessary in order to obtain a favourable resolution. The foregoing should be kept in mind due to the cash flow implications that could derive therefrom.

It is important to point out that even though the transfer of land (not including the transfer of other properties contained therein, that is, only the value of the soil) might be deemed as a value added tax-free operation, whenever real estate is involved in the acquisition of business assets, local taxes may be due (ie, transfer tax).

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Whenever the amount of authorised deductions exceeds the amount of taxable income, tax losses will be deemed to exist. Such losses may be used to reduce the taxable profit for the subsequent 10 tax years, until fully amortised. However, when in a given year a taxpayer fails to carry forward tax loss carry-forwards, even though such taxpayer could

have done so, said taxpayer shall forfeit the right to do so in subsequent years, for up to the amount that could have been carried forward.

When there is a change in the partners or shareholders that control a company with pending tax loss carry-forwards and the sum of the company's income in the preceding three years is less than the amount, updated for inflation, of those losses at the end of the last year before the change of partners or shareholders, such company may carry forward losses only to offset tax profits corresponding to the same type of business activities in which the losses were sustained.

Lastly, it should be noted that concerning mergers, the surviving companies are not entitled to use the losses generated by the merged companies and that losses of the surviving companies may only be used against gains generated as a result of the same type of business activities that gave rise to the losses prior to the merger.

According to Mexican tax laws, no special rules or preferential tax regimes apply for the acquisition of target companies subject to insolvency or bankruptcy procedures. However, taxpayers subject to such procedures may reduce debts remitted by their creditors (following the procedure set forth by the applicable laws) from pending losses in the relevant tax year in which the debt remittance took place. In cases where the amount corresponding to the remitted debts is greater than the pending losses, the differences therefrom should not be considered as accruable income unless the debts in question were originated by transactions between related parties.

## 8 Interest relief

### Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Mexican tax authorities and laws have assumed an aggressive position towards items related to or classified as interest payments. In that sense, in order for such payments to be deductible, certain requirements must be complied with. Therefore, thin capitalisation, transfer pricing and back-to-back rules, among other requisites, ought to be observed for such purposes. As outlined hereunder, the deductibility thereof is heavily conditioned.

Bearing the foregoing in mind, interest payments on borrowings obtained by a Mexican resident in order to acquire a target company could be deductible for income tax purposes provided that the lender's corporate purpose includes acquiring, holding and transferring stock of other companies.

Concerning the deduction of interest payments between resident companies and foreign related parties, certain thin capitalisation rules ought to be abided by. Resident companies may only be entitled to deduct such payments for as long as the total amount of debt contracted does not exceed three times the company's net worth. In cases where such debt-to-net-equity ratio is not complied with, interest payments would not be deductible for income tax purposes.

In connection with the above-mentioned, it is important to point out that companies engaged in specific industries (ie, the financial system and certain activities related to the country's strategic sectors) may be permitted to have higher debt-to-net-equity ratios provided that the tax authorities grant them an authorisation thereto.

Moreover, with regard to the applicable transfer pricing rules, corporate entities entering into transactions with non-resident related parties must determine their accruable income and authorised deductions bearing in mind that the price and other compensation for such transactions are equal to the amount that would have been paid to independent parties on an arm's-length basis.

Concerning back-to-back rules, yields on credits between related parties could receive the same treatment as if they were dividends.

Interest derived from foreign taxpayers is subject to income tax via withholding; nonetheless, non-resident parties should keep in mind that tax treaties entered into by Mexico could provide them with reduced withholding rates applicable thereto.

According to Mexican tax laws, debt pushdown is not an allowed practice. That being said, some operations between related parties could be deemed as debt pushdown operations. In this regard, tax

### Update and trends

On 25 July 2018, the second Mexican stock market (BIVA) was launched. SMPS was closely involved in the process of alerting the Mexican tax authorities of the need of issuing administrative rules (now contained in the Miscellaneous Tax Resolutions) to homologate the tax treatment applicable to transactions conducted through BIVA and the Bolsa Mexicana de Valores (BMV), formerly the sole authorised stock market in Mexico. These provisions were particularly required in order to guarantee that, in so far as certain requirements are met, investors disposing of shares via BIVA are also benefited from the reduced withholding tax rate of 10 per cent on taxable gains (instead of a tax rate of up to 35 per cent), that would have only applied to transactions carried out through the BMV had the provisions in question not been issued. Moreover, with the incorporation of BIVA, important changes to the provisions regulating the tax consequences for short-selling transactions and IPOs can be expected in the foreseeable future to further incentivise the Mexican stock market.

authorities, considering that no business motives are involved in such transactions, have denied the deduction of interest.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

As outlined in question 1, any tax liability prior to the acquisition of stock in the target company remains therewith after the transaction takes place.

Consequently, adequate representations and warranties in the negotiation proceedings are of paramount importance in order to minimise or avoid any potential tax liabilities or contingencies, to enable the acquirer (and in some cases even the target company) to seek indemnity, as well as to ensure that the seller's indemnities are backed up by collateral.

Likewise, regarding the acquisition of business assets, the purchaser could be jointly liable for taxes due by the seller of the ongoing business prior to the transaction, for up to the value of the business. In addition, other liabilities must be taken into account, for example, labour liabilities.

Based on the foregoing, it is essential to conduct exhaustive accounting, corporate and tax due diligence in order to verify the target's tax compliance, identify potential liabilities and, consequently, establish strategic vantage points in the negotiation proceedings.

The purchaser (or the target company) could be entitled to seek indemnity from the seller in cases where tax authorities determine the existence of liabilities or that tax due was not duly paid prior to the acquisition. In this respect, it should be noted that pursuant to the Federal Tax Code the statute of limitations regarding tax authorities' auditing powers is five years, although certain exceptions may apply, in which the statute of limitations is 10 years.

In general terms, resident companies or permanent establishments that receive indemnity-related payments ought to accrue such items for income tax purposes. Concerning non-residents, income tax due should be determined over the total amount of indemnities or damages paid by resident companies or permanent establishments located in Mexican territory.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

Evidently, and due to a multiplicity of factors, companies have different needs. As a result, post-acquisition restructuring should be treated as custom-made operations undertaken to implement the most tax-efficient structures and to address the relevant company's needs and interests.

In consideration of the foregoing, some of the most common means of post-acquisition restructuring consists of mergers or spin-offs (which could be treated as tax-neutral operations, under certain circumstances) or debt refinancing.

In some cases, Mexican entities involved in complex structures could opt to migrate foreign holding companies into the country as a means of restructuring.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Tax-neutral spin-offs may be executed in Mexico, provided that holders of at least 51 per cent of the voting stock in the existing and new companies remain the same (that is, their participation in the capital stock of the existing and new companies must be proportional to the voting share they had or have in the existing and new companies for a year before the transaction and two years thereafter).

Concerning monetary spin-offs, more than 51 per cent of the substantial monetary assets may neither be transferred to the new companies nor retained by the existing one in order for the operation to be deemed as tax-neutral. Failing to comply with the preceding requisite could give rise to a tax treatment in which a capital reduction and the transfer of property over such assets would be deemed to have taken place and, as a result, both income and value added tax could be payable.

Regarding tax loss, if the original company primarily conducted commercial activities, the tax loss carry-forwards pending for offsetting tax profits shall be divided between the original company and the companies spun-off in proportion to the division of the total value of inventories and accounts receivable related to the commercial activities of the original company. Other tax attributes are also divided between the entities.

Notwithstanding the above, local taxes may still be payable in cases where real estate is transferred, varying on the state in which the operation takes place.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Pursuant to applicable Mexican tax laws, the migration of residence of a target company in Mexico is not possible without triggering tax consequences. Should a resident corporate entity change its tax residence to another country, a liquidation for tax purposes would be deemed to exist and income tax could be due as if an arm's-length sale of assets had occurred. Therefore, the deemed transfer of assets (and the corresponding deemed distribution in favour of the shareholders) could be subject to taxation.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Dividends paid by resident companies are not subject to corporate taxation as long as they are paid out of the after-tax earnings and profits account that already has been subject to taxation. Should that not be the case, the entity paying dividends will be required to pay tax on the distribution of untaxed profits.

In addition, dividends paid to non-residents, whether individuals or legal entities, as well as to resident individuals, would be subject to an additional 10 per cent withholding tax. In some cases, Mexican individuals receiving dividends could have an additional tax burden of up to 5 per cent.

Yields on credits as well as debt claims could be classified as interests in accordance with Mexican tax laws; and as such, taxed when capital is invested in Mexico or when a resident or a non-resident with a permanent establishment in Mexico makes such payments.

In accordance to the foregoing, and in consideration of the debt's nature, the corresponding withholding rate could range from 4.9 per cent up to 40 per cent.

Non-resident parties should always bear in mind that tax treaties entered into by Mexico could provide them with relief regarding tax payable on interest and dividend payments made out of the country, such as lower withholding rates or the possibility to credit or deduct in their jurisdiction Mexican tax effectively paid.

#### 14 Tax-efficient extraction of profits

##### **What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Until recently, interest, royalty and service-related payments were commonly used by taxpayers to erode the taxable base of their operations.

Therefore, in order to address certain practices through which taxpayers were abusively extracting profits from the country (for instance, by way of abuse of tax treaties), tax authorities established more rigorous thin capitalisation and transfer pricing rules. It is worth mentioning that the Organisation for Economic Co-operation and Development has been developing base erosion and profit shifting programmes to address such matters.

As a result of the foregoing, the Mexican income tax law establishes limitations to the deductibility of interest deriving from excessive indebtedness of taxpayers with non-resident related parties in order to control operating debt margins. In that sense, debt arising from credits subject to distribution of dividends, sale of business assets, transfer of control and reduction of capital, among others, should be taken into account in order to determine the debt-to-net equity ratio referred to in question 8.

Concerning transactions between related parties, transfer-pricing provisions ought to be abided by. Consequently, regarding transactions between a resident taxpayer and a non-resident related party, the first should determine its accruable income and authorised deductions bearing in mind that the price and compensation for such transactions must be equal to that which would have been paid to an independent party (arm's-length principle).

#### **Disposals (from the seller's perspective)**

#### 15 Disposals

##### **How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Concerning disposals, non-residents may prefer disposing of the target's stock, as tax treaties entered into by Mexico could provide them with certain benefits.

In addition, from the seller's perspective, it is essential to consider the cost of acquisition of the shares in the target company. In cases where the cost of shares is deemed high, it could be convenient to dispose of the target's stock given that such cost could be deducted from the sale price in order to calculate income tax due.

Alternatively, in cases where the cost of shares is low, the seller could prefer to dispose of the target's assets.

Concerning transactions in which a company that holds stock in a target company whose assets are then sold to a third party, tax consequences triggered when the assets are transferred and when profits deriving therefrom are later distributed to the seller should be kept in mind.

#### 16 Disposals of stock

##### **Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Income deriving from the disposal of stock issued by a resident company could be subject to taxation at a rate of 25 per cent over the gross amount of the consideration corresponding thereto, when in the hands of a non-resident seller. Nevertheless, provided that certain requirements are met, non-residents could opt to calculate income tax due at a rate of 35 per cent over the capital gain in question (with the possibility to deduct the cost of the shares), that is, on a net basis. However, in order for the latter alternative to be available, non-residents must designate a representative in the country in charge of complying with several obligations, such as remitting the corresponding tax.

While the disposal of stock listed on the Mexican Stock Exchange, as well as other recognised markets, may be subject to a 10 per cent tax rate, no special rules are included in Mexican tax laws concerning the disposal of stock in companies related to the energy and natural resources industries.

In pursuance of some of the tax treaties entered into by Mexico, taxation on capital gains deriving from the transfer of stock could be limited or avoided (such as in cases where the non-resident seller has a minority participation in the Mexican entity, or simply due to the non-resident's jurisdiction).

Moreover, the disposal of stock issued by non-resident companies, 50 per cent or more of whose value derives from real estate located within the country, could be subject to taxation. In such cases, tax treaties may provide relief from taxation, assuming that certain conditions are met (eg, that real estate properties located in the country are used in the performance of its activities).



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**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Mergers, spin-offs and corporate reorganisation in connection with the disposal of stock or business assets may result in tax-neutral (or at least tax-efficient (deferral)) operations that may manage to change or even avoid taxation, as mentioned throughout this chapter.

In this regard, tax authorities may authorise the deferral of income tax payable over profits deriving from the disposal, by a non-resident of stock in a Mexican company, between companies belonging to the same corporate group (concerning stock-for-stock transactions). Income tax corresponding to the profits obtained from such a disposal of stock would be payable within 15 days of a second transaction or disposal by means of which the stock in question ceases to belong to any of the companies from the corporate group takes place.



# Morocco

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The difference in tax treatment between an acquisition of stock in a company and the acquisition of business and liabilities concerns the registration fees regime applicable to these operations.

- The acquisition of shares of a Moroccan company is exempted from registration fees since the 1st January 2018 (before Financial Law for budgetary year 2018 it was subject to registration fees of 4 per cent).
- If the acquisition of business assets and liabilities are part of a transfer of a business, this transaction will be subject to registration fees of 6 per cent while the inventory acquired in connection with the transfer of a business is subject to a registration fee of 1 per cent.

Also, business assets and liabilities are not subject to VAT except for the acquisition of tangible assets, which is subject to VAT (VAT general rate is 20 per cent).

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Following the provision of the General Code for the Accounting Standards, a step-up basis in the business assets is mandatory at the end of each financial year.

Intangible assets may be impaired through a provision in the context of which the depreciation of their value can be justified regardless of the event that justified the depreciation. However, this provision is not deductible in Morocco.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

The buyer's location has no importance as the tax consequences in terms of registration fees and VAT will be the same whatever the place of residence of the acquisition company.

However, with a view to avoid later capital gains it may be interesting to set up a holding company that will acquire the Moroccan target in a country exempting capital gains on shares (ie, Luxembourg).

Indeed, it could be interesting to locate the holding company in a state in which the tax law provides some exemption applicable to the capital gain related to the sale of shares.

## 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

The sale of shares is an option that is frequently used because it is simpler and quicker in its realisation. Moreover, for the entity that acquires it, it is more interesting for tax purposes because it is exempt from registration fees or subject to registration fees of 6 per cent (if the company is constituted with a majority of real estate assets) with no VAT applied.

Indeed, the transfer of business is subject to registration duties at the rate of 6 per cent and VAT for the tangible assets (goods) and triggers some operations, such as the transfer of commercial contracts to the purchaser for example.

The merger is used in the case of an intra-group transaction. But it involves a very significant tax control risk of the company being absorbed and therefore it is not a privileged option.

## 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

To the extent that an exchange of shares is assimilated to a sale of shares in Moroccan law, there is no specific advantage in issuing stock for tax benefit.

## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

Where there is a disposal of fixed assets without any transfer of a business (ie, stocks) no stamp duties apply. However, Moroccan VAT is applicable.

Where the acquisition of business assets and liabilities are part of a transfer of a business, this transaction will be subject to registration fees of 6 per cent while the inventory acquired in connection with the transfer of a business is subject to a registration fee of 1 per cent.

The acquirer is accountable for the payment of the registration fees. In case VAT is applicable, it is also paid by the acquirer but the seller is required to remit the VAT to the Moroccan treasury.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Tax losses may be carried forward for a period of four years from the end of the loss-making accounting period. However, losses may not be carried back.

According to article 232(I) of the Moroccan General Tax Code (GTC) the statute of limitation is four years following the end of the financial year concerned.

However, in application of article 232(III) of the Moroccan GTC, whether the Moroccan entity has registered some loss carry-forward which has been deducted from a tax year subject to tax audit, the Moroccan tax administration can extend its tax audit to the last four closed years. This extension of the statutes of limitation could also be applicable by the Moroccan tax administration in case of VAT credit.

The change of shareholder (ie, takeover) does not affect the possibility of deferring the deficits.

In case of merger, article 162-II, H of the GTC provides that the accumulated deficits shown in the tax return for the last financial year preceding the merger cannot be carried forward for the following financial years.

No special tax regime is applicable to the acquisitions or reorganisations of bankrupt or insolvent companies.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interests on borrowings are deductible provided that the debt is incurred for the needs and in the interest of the company. Thin capitalisation rules apply to reduce the deduction available where the taxpayer is a foreign entity operating in Morocco, a foreign controlled Moroccan entity or a Moroccan resident with foreign business investments. In each of these cases, the tax deduction for interests may be reduced if the taxpayer's debt exceeds the levels permitted under the thin capitalisation provisions.

In case the loan is granted by a foreign shareholder, the tax deductibility of interests paid by the company should be granted within the following limits (thin capitalisation rules):

- the amount of the shareholder loan does not exceed the amount of the share equity capital (ratio 1:1); and
- the interest rate does not exceed the rate annually fixed by the Ministry of Finance during a tax year (ie, 2.22 per cent for 2018).

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

In the case of a transfer of business, shares or stocks, the preferred form of guarantee is the guarantee of liabilities.

There is no specific documentation required, however, we recommend that the selling contract specifies in maximum detail the assets sold and the conditions for the buyer to assert its rights.

The guarantee of liabilities is a specific clause within the contract of assignment. The payment of an indemnity under such guarantee is considered from tax purpose as an income for the purchaser.

In this context, this indemnity is subject to corporate income tax under Moroccan tax regulation.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

There is no typical post-acquisition restructuring. However, the buyer might consider relocating its activity to within an Export Free Zone (EFZ).

Moroccan companies that operate in the EFZ benefit from the following on their export turnover:

- a total exemption during the five first successive tax years as from the date corresponding to the beginning of their activity;
- the application of a corporate income tax rate reduced to 8.75 per cent during the following 20 tax years; and

- the application of a corporate income tax rate reduced to 17.5 per cent beyond this period.

The installation in an EFZ is not automatic and requires a prior authorisation of the authorities in charge of the said area.

Please also note that services companies (financial institutions and professional services providers) and holding companies with the Casablanca Finance City (CFC) status shall benefit, in respect of their export revenues and net capital gains from the sale of foreign securities for the financial period from:

- a total exemption from corporate tax for a period of five consecutive years, starting the first year they have been granted Casablanca Finance City status; and
- a reduced corporate tax rate of 8.75 per cent beyond this period.

Export revenues eligible for exemption are those relating to the last service rendered on Moroccan territory for the direct and immediate purpose of exporting. Moreover, 'service exports' means operations used or consumed overseas for which revenues are generated in foreign currencies.

Entitlement to advantages granted to services companies with the CFC status takes effect from the financial period in which the CFC status is granted.

In terms of personal income tax: CFC entities' employees can benefit from a special regime: application of a 20 per cent flat tax rate during a period of five years as from the beginning of their activity and the obtention of the CFC status by their employer.

However, in case of application of this special tax regime (flat rate of 20 per cent) the taxable basis for personal income tax will be the gross amount of the wage (including the employee part of social contribution) without any deduction.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

According to article 162 of the GTC, totally merged or totally spun-off companies are not taxed on the net capital gain realised as a result of the contribution of the fixed assets and equity, provided that the acquiring company, or the newly created entity issued from the operation, file to the tax administration, within 30 days following the date of the merger a written declaration that includes:

- a summary statement of the contributed assets containing all the details of the capital gains realised or the losses incurred and indicating the net capital gain that will not be imposed in the merged or spun-off company;
- a statement concerning, for each of these companies, the provision appearing on the liabilities side of the balance sheet, including those not subject to tax deductions;
- the act of merger or spin-off into which the absorbing company or the newly created entity commit to:
  - record, for their full amount, the provisions for which the tax is deferred;
  - reintegrate in the corporate results, the net capital gain realised by each of the companies merged or spun-off on their contribution:
    - whether on the aggregate of the equity retained and of the assets where, among these items, the value of the lands is equal to or greater than 75 per cent of the aggregate value of the net assets of the company concerned. In this case the net capital gain is re-integrated with the result of the first financial ending after the merger or spin-off; and
    - whether only on the depreciable assets when the proportion of 75 per cent referred above is not reached. In this case, the net capital gain realised on the contribution of the depreciable assets is reintegrated into the taxable results, in equal proportions, over the amortisation period of those assets. The value of those elements is taken into account for the calculation of the depreciation and subsequent capital gains; and

- add to the capital gains realised or realised at the time of the withdrawal or disposal of the assets not concerned by the reintegration provided for here above, the capital gains realised by the merged or spun-off company and whose taxation has been deferred.

The merged or spun-off premium realised by the absorbing company and corresponding to the capital gain on its shareholding in the merged or spun-off company is exempted.

Capital gains resulting from the exchange of securities of the company absorbed or spun-off, carried out in connection with the merger or spun-off transactions, are taxable only by the time of the sale or withdrawal of such securities.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

The transfer of the residence of a Moroccan company outside of the jurisdiction is not an operation provided for by the Moroccan law, nor is the transfer of the residence of a foreign company to Morocco possible.

In this context, the transfer of residence implies the liquidation of the existent company and the setting up of a new legal entity.

The liquidation of the existent company will have tax consequences notably regarding corporate income tax (ie, taxation of the unrealised capital gains).

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Dividends paid to a non-resident are subject to a 15 per cent withholding tax unless the rate is reduced under an applicable double tax treaty. Interest and royalties payments made out of Morocco are subject to a withholding tax of 10 per cent. There is an exemption in the withholding tax applicable to interest in case of loans contracted in foreign currencies for a period of 10 years.

Moreover, the rate of this withholding can be reduced by the application of a double tax treaty agreement entered into force between Morocco and a third country. Depending on the provision of the aforementioned double tax treaty agreement, the withholding might be deducted from the tax results of the foreign company which receive the payment.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

As most of our clients are established within the EU, we usually recommend they use the parent-subsidiary regime when possible. Using this parent-subsidiary regime, a French company that receives a dividend of its Moroccan subsidiary would bear the cost of the withholding tax of 10 per cent, the dividends would be exempted from corporate income tax in France on the condition that a reintegration of a portion of costs and expenses set at a fixed rate of 5 per cent takes place.

In addition to paying dividends, the payment of management fees, service fees and royalties are methods of repatriating profits to the parent company. However, the payments made by the Moroccan company must reflect the market value of the goods sold and the service rendered to the Moroccan company.

Indeed, article 213 (II) of the GTC provides that where a company has ties of dependence with companies located in Morocco or outside Morocco, the profits indirectly transferred, either by way of increase or decrease in the purchase or sale prices or by any other means, shall be included in the corporate results.

To this end, profits indirectly transferred shall be determined by comparison with those of similar companies or by direct assessment on the basis of information available to the administration.

In this order, article 7 of Finance Act 40-08 for the budgetary year 2009 introduced an obligation for businesses that are taxable in Morocco to supply the tax authority, at its express request, with documents and information relating to transactions undertaken with related entities established outside Morocco. This obligation is now contained in article 214 (III) of the Moroccan GTC.

Under article 214 (III) of the Moroccan GTC, documents relating to transfer prices must be sent at the request of the authority (in the form of a letter giving notice) within 30 days of receipt of that request.

Article 214 (III) of the Moroccan GTC stipulates that the authority may request all documents and information relating to the following matters:

- the nature of the relationship connecting the company that is taxable in Morocco with the one located abroad;
- the nature of the services provided or of the products sold;
- the method by which the price of transactions between the companies has been determined, and the documents supporting it; and
- the regimes and tax rates applicable to the businesses situated outside of Morocco.

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**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Disposals are most commonly carried out with the stock in the local company.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

The disposal of stock realised by a foreign company will be taxed in Morocco in accordance with the corporate income tax rates.

There are special incentives for the activities related to oil and gas production. These activities are taxed under the common Moroccan tax rules, subject to a certain number of advantages granted by the Moroccan state to oil and gas operators in order to promote their activities in Morocco.

Listed here are some tax incentives provided under the Hydrocarbon Code:

- the holder, or as the case may be, the co-holders of any exploitation concession benefit from a total exemption on corporate income tax during a 10-year period starting as from the date of the beginning of the regular production of any exploitation concession;
- all equipment, products and services necessary for the reconnaissance, exploration and exploitation works are exempted from value added tax (VAT) and custom rights; and
- the profits and dividends of the exploitation concessions holders (and those of the shareholders of the concession companies) are exempted from any taxes and may freely be repatriated outside Morocco without limitations for foreign entities.

The holder of an exploration permit or an exploration concession benefits from an exemption on Business Licence Tax.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

There are no such arrangements within Moroccan tax law.



# Netherlands

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Upon the acquisition of stock, and where the acquisition company is a Dutch entity, the participation exemption may apply. Under the participation exemption, income (including dividends and capital gains) from a qualifying participation is exempt from Dutch corporate income tax. On the other hand, losses on a qualifying participation are in principle non-deductible. Acquisition and sales costs, earn-out payments, payments under (balance sheet) guarantees and indemnities are generally not taxable or tax-deductible under the participation exemption (see question 15 for the participation exemption conditions).

In the case of an acquisition of the legal and economic ownership of at least 95 per cent of the nominal and paid-up stock by the acquisition company, a fiscal unity (tax grouping) may be formed between the acquisition and acquired companies. Companies forming a fiscal unity can set off losses (eg, from interest costs on acquisition financing) and profits (eg, of the acquired company), albeit under certain conditions (see question 8).

Acquisition of stock in a real estate entity may be subject to 6 per cent Dutch real estate transfer tax (RETT). The purchase of stock in a Dutch company is generally not subject to Dutch VAT (see question 6). In the case of a purchase of stock, the book value of the assets reported by the company acquired remains unchanged.

In the case of a purchase of business assets and liabilities (asset transaction), the acquisition company should report the acquired assets at fair market value. The purchase of Dutch real estate is, in principle, subject to 6 per cent RETT. The asset transaction is, in principle, a taxable event for VAT purposes, but may be non-taxable in case of a purchase of 'totality of goods'. For additional taxes, see question 6.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Only in the event of an asset transaction does a step-up to fair market value apply to the acquired assets and liabilities. The depreciation of those assets (including acquired goodwill and other intangible assets) is tax deductible. However, the annual amount of tax-deductible depreciation is limited to 10 per cent of the cost price for acquired goodwill and 20 per cent of the cost price for other intangible assets.

For tax purposes, acquired stock in a company is booked at historical cost price. If the participation exemption applies, no tax-deductible depreciation of stock is possible. The book value of the assets reported by the company acquired remains unchanged.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

It is preferable to use a Dutch acquisition company to execute an acquisition for several reasons.

The main advantage of using a Dutch acquisition company for the acquisition of stock in a Dutch target company is the possibility to form a fiscal unity between the Dutch acquisition company and the company acquired. To form a fiscal unity, the Dutch acquisition company would (among other conditions) need to acquire the legal and economic ownership of at least 95 per cent of the nominal and paid-up shares in the company acquired. Subject to certain anti-abuse legislation, forming a fiscal unity would, for instance, allow the Dutch acquisition company to set off losses against the profits realised within the fiscal unity.

For acquisitions of stock in a non-Dutch company, it may be beneficial to use a Dutch acquisition company for the following reasons:

- tax-efficient repatriation of funds (eg, reduced withholding tax rates) by means of the numerous tax treaties concluded by the Netherlands for the avoidance of double taxation, in combination with the participation exemption;
- asset protection through one of the many bilateral investment treaties concluded by the Netherlands; and
- highly skilled professional advisers and support (banks, lawyers) and an efficient court resolution by a separate court for entrepreneurial disputes.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Legal mergers and share-for-share mergers (hereafter jointly referred to as 'mergers') are not that common as they are not the most straightforward method of acquisition. A possible advantage of a merger lies in the fact that, although subject to the terms of the transaction, it could be possible to minimise the need to attract funding by the acquisition company and limit the spending of cash.

Additionally, when contemplating an asset transaction by way of a business or legal merger, mergers are considered as beneficial, as these provide the opportunity to continue reporting the 'acquired' assets and liabilities at historical cost price (instead of reporting at fair market value) and thus postpone taxation of unrealised profits for the 'seller'.

The main disadvantage of such tax-neutral business or legal mergers is the possible inflexibility of on-selling the merged company within the respective clawback period (generally three years) imposed by anti-abuse measures. If applicable, the clawback rules stipulate that the postponed taxation of unrealised profit reserves is reversed, resulting in the taxation of the unrealised profit reserves with retroactive effect.

### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

It may be beneficial for the buyer to issue stock in the event that cash funding cannot be obtained by the acquisition company, or in case

interest costs on acquisition financing cannot be deducted (under anti-abuse legislation). See question 8 for more information on interest deduction limitations.

With reference to question 4, it is possible to postpone taxation when issuing stock as consideration for the acquisition.

## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

In the case of an acquisition of existing or newly issued stock, no stamp duty (or other documentary taxes) is due.

However, there is a possibility that, upon an acquisition of stock, 6 per cent RETT is due if the target company qualifies as a 'real estate entity'. This is the case if all of the following requirements are met:

- the stock is acquired in an entity with an equity divided into shares, or an entity incorporated under the laws of another state that has the same characteristics of an entity with an equity divided into shares;
- the stock is acquired in an entity of which, at the time of the acquisition or at any time in the preceding year, the assets consist or consisted of 50 per cent or more of real estate, and at least 30 per cent of all assets consist of Dutch real estate;
- the activities pertaining to the real estate consist, at the time of the acquisition or at any time in the preceding year, of 70 per cent or more of the acquisition, disposal or exploitation of that real estate; and
- the buyer directly or indirectly acquires an interest of at least one-third in the entity, including any interest the buyer may already directly or indirectly hold.

For VAT purposes, the acquisition of stock should not be considered a taxable event.

In the case of an asset transaction, no stamp duty (or other documentary taxes) should be due. Upon the acquisition of Dutch real estate, 6 per cent RETT is normally due. However, the acquisition of Dutch real estate may be exempt from RETT if the transaction relates to certain types of mergers, split-offs or internal reorganisations.

The acquisition of assets is normally subject to 21 per cent VAT. The transfer of real estate is generally exempt from VAT, unless the transfer concerns newly developed real estate (ie, construction sites and (part of) buildings including the surrounding terrain, prior to, on or within a period of two years after the moment of first use of the buildings concerned). Should a transfer of real estate indeed be subject to VAT, an exemption generally applies for RETT.

Finally, in the case of an asset transaction where a 'totality of goods' is acquired, the acquisition may be considered as a non-taxable transfer for VAT purposes.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

In the case of an asset transaction, the losses remain with the seller and may be set off by the seller against the capital gains realised with the sale.

In the case of an acquisition of stock in a company (regardless of its status) with a tax-loss carry-forward, the company acquired may still utilise the losses post-acquisition, subject to specific restrictions in case the acquisition of that company results in a 'change of control'. In this respect, a change of control is generally considered to be the case if the transferring shareholder directly or indirectly alienates an interest of 30 per cent or more in the transferred company.

Subject to certain exceptions, losses generally remain available after a change of control, provided that all of the following requirements are met:

- the losses did not occur in a year wherein the assets of the acquired company consisted mostly (50 per cent or more) of passive portfolio investments for a period of at least nine months;
- just prior to the acquisition, the activities of the target company have not been reduced to less than 30 per cent when compared to the activities of the company when it incurred the oldest losses available for compensation; and
- at the time of the acquisition, it is not intended to reduce the activities of the target company to less than 30 per cent (as described in the above point) within three years of the acquisition.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interest expenses are, in principle, tax deductible. However, various anti-abuse measures may deny the deduction of interest expenses on loans due to related entities. Generally speaking, the acquisition company and a lender are considered related entities if:

- the lender directly or indirectly holds an interest of at least one-third in the acquisition company;
- the acquisition company directly or indirectly holds an interest of at least one-third in the lender; or
- an entity directly or indirectly holds an interest of at least one-third in both the acquisition company and the lender.

Firstly, it is noted that interest costs on loans to related entities exceeding an arm's-length rate are in principle requalified (for the part that is not at arm's length) into non-deductible deemed dividends or informal capital contributions. In addition, loans between related parties may be provided under such conditions that, for Dutch tax purposes, these loans are requalified into equity. Consequently, interest payments on such requalified loans are treated as deemed dividends or informal capital contributions.

Below is a short elaboration of the most important interest deduction limitations for debt acquisition financing.

### Anti-abuse legislation for specific types of transactions

According to specific anti-abuse legislation, the deduction of interest (including foreign exchange results) may be denied if a Dutch-resident company finances one of the following transactions with a loan obtained from a related party:

- profit distribution or capital repayment to a related party;
- capital contribution in a related party; or
- the acquisition of an interest in a company, which after the acquisition, constitutes a related party.

The deduction of interest expenses will nevertheless be allowed if the company paying the interest can substantiate that:

- the loan, as well as the related transaction, are both mainly based on sound business reasons;
- the interest received by the lender is taxed at a rate that is considered to be reasonable for Dutch tax purposes (10 per cent or more); or
- the loan is ultimately provided by unrelated parties.

The Dutch tax authorities may nevertheless deny the deduction of interest expenses if they successfully demonstrate that the loan has been entered into in anticipation of loss compensation by the lender.

### Anti-abuse legislation applicable to related and non-related loans

Anti-abuse legislation is applicable to related and non-related loans by way of limitation of excessive interest deduction rules and specific fiscal unity rules.

### Limitation of excessive interest deduction

The amount of non-deductible 'excessive interest' is the proportionate total amount of interest expenses (including related costs) set off

against the average total amount of debt deemed used to finance the target company and the average total amount of debt outstanding.

Subject to certain exceptions, debt is deemed to be used to finance the acquisition of a target company if the amount of the combined historic cost price of all the taxpayers' participations exceeds the taxpayer's equity.

A threshold of €750,000 (per annum) applies based on which the deduction of excessive interest expenses up to this amount will not be limited.

### Fiscal unity

Pursuant to other anti-abuse legislation, the deduction of interest expenses may be limited where the acquiring company has obtained a loan (whether from a related party or not) used for the purchase of the acquired company (acquisition loan), and mentioned companies form a fiscal unity directly after the acquisition.

The above-described limitation of interest deductibility only applies to the extent that the annual interest on the acquisition loan amounts to more than €1 million, and only to the extent the interest expenses relate to 'excessive' acquisition loans. Subject to certain provisions, the initial acquisition loan is considered excessive if the nominal value of the obtained acquisition loan is more than 60 per cent of the acquisition price of the acquired company.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

It is not uncommon that the acquisition company and seller agree on a full indemnity by the buyer for tax costs (increased with interest and penalties) relating to the pre-acquisition (pre-effective date) period and that are not provided for in the acquisition balance sheet of the acquired company for the statutory limitations period. Often the maximum indemnity is limited to the value of the acquisition price.

The tax indemnities are often described in a separate tax schedule to the share-purchase agreement. If the acquired company formed part of a fiscal unity, specific warranties and indemnities are agreed with regard to liabilities relating to the period of such fiscal unity period.

In the case of a purchase of stock, and assuming the participation exemption applies, payments under an indemnification or warranty should generally be tax-neutral for both the acquisition company and the seller, as the payments would normally be considered a non-taxable correction of the initial purchase price or a reimbursement for (future) expenses or liabilities or both.

In case of an asset transaction, only limited tax warranties are provided by the seller as the tax liabilities generally do not pass to the acquisition company.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

The most typical post-acquisition restructuring is the formation of a fiscal unity between the acquisition company and the target company. See question 3 for more details on fiscal unity.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

For Dutch corporate income tax purposes, a spin-off can be executed tax-neutrally if the splitting company and the receiving company meet certain requirements. One of these requirements is that neither the splitting company nor the receiving company may have any net operational losses. In case not all the requirements are met, unrealised profit reserves of the transferred assets are fully taxed unless the spin-off is

performed in line with the conditions laid down in a ministerial decree. For transfer taxes, see question 6.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

In principle, the migration of a company that is resident in the Netherlands for Dutch tax purposes leads to taxation of all unrealised gains and losses, as all assets and liabilities are deemed sold just prior to migration. The migrating company, however, may opt for a deferral of payment of the taxation, subject to certain conditions.

Two different options exist for a deferral of payment upon migration. The first option provides for a deferral of payment of the tax due until the moment the gains and losses have been effectively realised, taking into account the following:

- the deferral only applies insofar as the company migrates to and remains resident of an EU member state or a jurisdiction within the EEA;
- the deferral only includes taxation of unrealised gains and losses, which is annually assessed by information provided by the migrating company (ie, the annual filing of the fiscal balance sheet, profit and loss account and additional information based on which the Dutch tax authorities can determine whether the gains and losses of the underlying assets have effectively been realised);
- the deferred payable amount will be increased with (levy) interest calculated over the amount of tax due as per the migration date; and
- the migrating company has to provide sufficient assurance to the Dutch tax authorities (in most cases a bank guarantee) for the postponed tax liability.

The second option provides for the opportunity to pay the tax due upon migration (to jurisdiction within the EU or EEA) in 10 equal annual instalments. These 10 instalments are payable, regardless of whether the gains and losses of the underlying assets have been effectively realised. Although (levy) interest will be calculated and sufficient assurance must be also provided to the Dutch tax authorities, no further administrative requirements are imposed to the taxpayer opting for payment in 10 instalments.

A migration of a pure Dutch holding company only owning shares in (foreign) subsidiaries would normally not lead to a Dutch corporate income tax liability, as any gains (or losses) on those shares should be exempt under the application of the participation exemption. (See question 15 for more information on the application of the participation exemption.)

Should the migrating company continue to (partially) remain a Dutch resident for Dutch corporate income tax purposes – for instance, as a result of a Dutch permanent establishment – the unrealised gains and losses of the assets attributable to the Dutch permanent establishment would not be taxed as a result of the migration.

In addition to the above, should the migration of the company not only result in the migration of the effective place of management but also realise the migration of the corporate seat, the migration may also trigger Dutch dividend withholding tax. The migration of the corporate seat can (effectively) be realised by a cross-border conversion and a cross-border merger.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

### Dividend distributions

Dividends distributed by a Dutch BV (private limited company) or NV (public limited liability company) to a foreign shareholder are generally subject to 15 per cent Dutch dividend withholding tax. However (except for specific abusive situations), an exemption of dividend withholding tax applies if:

- the shareholder is considered tax resident in a member state of the EU, a state of the EEA or a third country that has entered into a

## Update and trends

### Multilateral instrument

#### Background

The Netherlands signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) on 7 June 2017. The MLI is one of the key outcomes of the OECD Base Erosion and Profit Shifting Project and aims to prevent international tax avoidance. The MLI will only affect tax treaties if both tax treaty partners are signatories to the MLI and both parties have designated a tax treaty as a 'covered tax treaty' or CTA.

#### 82 Covered tax agreements

The Netherlands has designated tax treaties with the following jurisdictions as a CTA: Albania, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Bangladesh, Barbados, Belarus, Yugoslavia -Bosnia and Herzegovina, Canada, China, Croatia, Czechoslovakia-Czech Republic, Egypt, Estonia, Ethiopia, Finland, France, Georgia, Germany, Ghana, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Israel, Italy, Japan, Jordan, Kazakhstan, Kenya, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia (FYROM), Malawi, Malaysia, Malta, Mexico, Moldova, Yugoslavia-Montenegro, Morocco, New Zealand, Nigeria, Norway, Oman, Pakistan, Panama, Philippines, Portugal, Qatar, Romania, Russian Federation, Saudi Arabia, Yugoslavia-Serbia, Singapore, Czechoslovakia-Slovak Republic, Slovenia, South Africa, Sri Lanka, Suriname, Sweden, USSR-Tajikistan, Thailand, Tunisia, Turkey, Uganda, United Arab Emirates, United Kingdom, United States of America, Uzbekistan, Venezuela, Vietnam, Zambia, Zimbabwe.

#### Most important changes

The most important changes following the MLI are considered to be the introduction of the Principal Purpose Test (PPT) and the revision of the preamble that states that the relevant tax treaty is not intended to provide double taxation, nor opportunities for non-taxation or reduced taxation.

### Principal Purpose Test

The PPT provision essentially denies a treaty benefit if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the CTA.

### Mandatory Disclosure Directive

On 25 May 2018, the Mandatory Disclosure Directive (the Directive) was formally adopted by the Council of the European Union. The Directive introduces mandatory disclosure rules for intermediaries, regarding any kind of tax except for VAT, custom duties, excise duties and compulsory social contributions.

Intermediaries (such as lawyers, accountants, tax advisers and financial advisers) with residency, incorporation, professional registration or a permanent establishment in an EU member state fall within the scope of the Directive. These intermediaries are required to report any cross-border arrangement concerning at least one EU member state, which consists of potentially aggressive tax planning that fall within a set of 'hallmarks' set out in the Directive. Such arrangements should be reported within 30 days of having been made available to the client. The Directive also provides the means for tax administrations to exchange information on these arrangements to other member states by means of automatic information exchange protocols. In cases where there is no intermediary involved in the arrangement, the obligation to report lies with the client or its in-house tax department. Non-compliance with the Directive by intermediaries or clients will lead to penalties.

EU member states should implement the Directive in their domestic legislation ultimately on 31 December 2019. The Directive will become applicable on 1 July 2020 and will have retroactive effect for all arrangements of which the first step of implementation takes place in the time frame between the entry into force and the application of the Directive. As of 31 October 2020, the first information will be exchanged between EU member states and thereafter they are obliged to exchange information every three months.

tax treaty with the Netherlands that contains qualifying provisions relating to dividend; and

- the shareholder owns an interest to which the Dutch participation exemption would be applicable if the foreign shareholder were a resident of the Netherlands.

If the Dutch dividend withholding tax exemption applies, the Dutch Tax Authorities have to be notified within a month of the distribution of the dividend. The Dutch dividend withholding tax exemption also applies to distributions made to a hybrid entity, provided certain conditions are met.

Important to note is that a holding cooperative (ie, the activities of the cooperative consist for at least 70 per cent of holding participations or direct or indirect intra-group financing activities) with qualifying membership rights (ie, the holder of the membership rights is eligible to at least 5 per cent of the annual profits or the proceedings from the possible liquidation of the holding cooperative) is treated similar to a Dutch BV or NV. Therefore, a holding cooperative falls within the scope of the dividend withholding tax and the dividend withholding tax exemption as discussed above. However, a regular cooperative is always exempt from dividend withholding tax.

Furthermore, if the shareholding is attributable to a Dutch permanent establishment, dividend distributions would not be subject to dividend withholding tax insofar as the derived income from the shareholding is exempt from Dutch corporate income tax under the application of the participation exemption.

Most tax treaties allow for a reduced dividend withholding tax rate of 5 per cent, or in some occasions zero per cent if the required conditions are met.

### Interest payments

Interest payments are, in principle, not subject to (withholding) tax unless, and in as far as, the interest costs on related-entity loans exceed an arm's-length rate or in case the loan is requalified into equity for Dutch tax purposes. Interest distributions that have been reclassified as dividends are taxed as regular dividend distributions.

### Substantial interest taxation

Income (including dividend, capital gains and interest payments) derived by a non-resident may also be subject to Dutch corporate income tax in the case where the income is derived from a 'substantial interest' in a Dutch company. As a general rule, a foreign company is considered to have a substantial interest if such entity is entitled to at least 5 per cent of the value or voting rights in a Dutch company. Income derived from a substantial interest is subject to Dutch corporate income tax if:

- the substantial interest is held with the main purpose (or one of the main purposes) being to avoid Dutch individual tax of another person; and
- the structure can be considered artificial or put in place through a series of artificial arrangements.

## 14 Tax-efficient extraction of profits

### What other tax-efficient means are adopted for extracting profits from your jurisdiction?

The Netherlands has an elaborate tax treaty network, providing respective residents with heavily reduced withholding tax rates. In addition, Dutch companies can benefit from EU directives (such as the EU Parent-Subsidiary Directive). The most common method to reduce (or often even avoid) withholding taxes on the repatriation of profits is to organise the corporate structure in such a way that these tax treaty benefits (or European directives) are made use of in an optimal manner.



**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The sale of stock in either a local or foreign company would normally be the most beneficial disposal for a Dutch corporate seller, as capital gains are exempt from Dutch corporate taxation if the participation exemption applies. The participation exemption applies if the following requirements are met:

- the Dutch parent company holds at least 5 per cent of the nominal issued and paid-up capital of a (local or foreign) company of which the capital is partially or wholly divided into shares; and
- the subsidiary company is not considered to be held as 'portfolio investment' (the 'motive test').

Generally, a participation is held as portfolio investment if it is held with the intention to realise a yield that might be expected in case of regular asset management.

In cases where the motive test is not met, the participation exemption nevertheless applies when the 'tax rate test' or the 'asset test' (or both) is met. These tests are satisfied when:

- the participation is subject to a (foreign) tax rate of at least 10 per cent with a tax base roughly similar to the Dutch tax base (tax rate test); and
- the fair market value assets of the direct and indirect subsidiary consist of less than 50 per cent of 'low-taxed free portfolio investments' (asset test).

In essence, low-taxed portfolio investments are those assets that do not have a function in the business enterprise of the entity holding the asset, and the income related to the assets is not subject to a tax rate of at least 10 per cent.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

The gain derived by a disposal of stock in a Dutch company by a non-resident company should, in principle, not lead to Dutch taxation. If the stock qualifies as a substantial interest, however, the capital gains may be taxed with Dutch corporate income tax. For more information on substantial interest taxation, see question 13.

Under most tax treaties concluded by the Netherlands, the levy of capital gains is allocated to the country of residence of the shareholder and is exempt from taxation in the source state (ie, the Netherlands). Thus, if the non-resident company may apply for the application of such tax treaty, the disposal of stock should not be subject to Dutch taxation, regardless of whether or not the income is derived from a substantial interest.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

A disposal of shares is generally exempt under the application of the participation exemption. See question 15 for more information on the participation exemption.

A disposal of business assets is, in principle, taxable with Dutch corporate income tax unless the tax payer appeals to a special tax incentive, such as the tax-neutral mergers described in question 4. Additionally, a company selling an asset may also apply for the reinvestment reserve.

The selling company may apply for the reinvestment reserve provided that the taxpayer has a clear intention of replacing the sold assets with assets that perform a similar function within the enterprise. Additionally, the reinvestment reserve only applies for qualifying business assets used in an enterprise (ie, no shares).

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# Nigeria

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Although the same laws apply, there are significant differences between the tax treatment of an acquisition of stock in a company and an acquisition of business assets and liabilities of that company, as shown in the analysis below.

#### Acquisition of stocks

There are no transfer or capital gains taxes in Nigeria on the sale of shares. The Capital Gains Tax Act 2004 (CGT Act) exempts any gains realised by a person from a disposal of shares from capital gains tax. In addition, the Stamp Duties Act 2004 (Stamp Duties Act) exempts instruments for the transfer of shares (share transfer forms) from the payment of stamp duty. In practice, however, parties to share acquisition transactions will usually stamp the share transfer forms at a nominal rate of 500 naira (about US\$1.50) for the document stamped as the original and 50 naira (about US\$0.15) for each document stamped as a counterpart. Furthermore, where parties enter into share sale and purchase agreements to document the terms of such transfers, the parties will usually stamp that agreement, and the rate of stamp duty payable on such agreement can only be determined following an assessment of the agreement by the Commissioner for Stamp Duties (Commissioner). On a related note, if the shares are held in a public company listed on the Nigeria Stock Exchange, certain fees and taxes will be paid in relation to the transfer and the rates for those fees range from 0.06 per cent to 1.35 per cent. The fees are calculated on an ad valorem basis (ie, they are calculated based on the value of the transaction). Fees payable in relation to the transfer of shares in a public listed company are currently exempted from VAT. This exemption, which was granted for a period of five years, took effect on 25 July 2014 and will end on 24 July 2019.

#### Business assets

The transferor of business assets has an obligation, unless the transferor is among the entities exempted from the tax, to pay capital gains tax on any gains realised from a disposal of the assets at the rate of 10 per cent.

The Stamp Duties Act also requires stamp duty to be paid on instruments executed in connection with the transfer of such assets. The ad valorem rate at which stamp duty is assessed on such agreements is 1.5 per cent of the value of the transaction, with the Commissioner having the final say in relation to the assessment. The obligation to pay stamp duty is imposed on the purchaser of the business assets. Stamp duty must be paid within 40 days after the date of execution of the instrument, in the case of instruments liable to stamp duty at a nominal rate, and within 30 days after execution in the case of instruments liable to stamp duty at an ad valorem rate. Where an instrument is executed outside Nigeria, stamp duty on such instrument must be paid within 30 days from the date after the instrument is first received in Nigeria. The Stamp Duties Act provides that failure to stamp an instrument will render such instrument inadmissible as evidence in any civil proceedings before any Nigerian court or arbitrator. In addition, the Stamp Duties

Act provides, among other things, that failure to stamp, or the insufficient stamping of, instruments liable to ad valorem duty, is an offence for which the person with the obligation to pay stamp duty could be liable to conviction.

The Value Added Tax Act 2004 (as amended) imposes VAT on the value of the consideration for the supply or purchase of taxable goods or services in Nigeria except where those goods or services are expressly exempted from the tax. The goods exempted from VAT include plants, machinery and equipment purchased for utilisation of gas in downstream petroleum operations; farming machinery and farming transportation equipment; and tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes. Consequently, where some of the business assets to be acquired are among those liable to VAT, the buyer will have an obligation to pay VAT on the consideration payable for such assets at the rate of 5 per cent. What this means is that the seller of the business assets will have an obligation to add VAT to the consideration, collect the VAT from the buyer and remit same to the Federal Inland Revenue Service (FIRS) within 21 days from the date of the transaction. Where a purchaser of the assets is a company that is operating in the Nigerian oil and gas sector, such a purchaser is not permitted to pay the VAT on the invoice to the seller, rather the purchaser is required to withhold the VAT and remit same to the FIRS. There is currently no VAT on the transfer of real estate and intangible properties in Nigeria.

If the business assets include land then, in addition to the payment of stamp duty and capital gains tax, other fees will be payable in connection with such transfer, to the respective governments of the Nigerian states in which such land is located. The fees vary across the 36 states of Nigeria and the Federal Capital Territory. In Lagos State, for instance (Nigeria's main commercial centre), other fees payable in connection with a transfer of land amount in the aggregate to 3 per cent of the assessed fair market value of the property. This is broken down into:

- governor's consent fees – 1.5 per cent;
- capital gains tax – 0.5 per cent;
- stamp duties – 0.5 per cent; and
- registration fees – 0.5 per cent.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

#### Step-up in basis

We understand step-up in basis to mean the readjustment of the open market value of an asset that has appreciated for tax purposes following the inheritance of that asset by another person. Although this rule is not expressly stated to be applicable under Nigerian law, the CGT Act states that on the death of an individual, any of his or her assets shall be deemed to be disposed of by him or her at the date of his or her death and acquired by his or her personal representatives, or other persons on whom the asset devolved, for a consideration equal to: if the amount of the consideration for which the asset was purchased by way of a bargain made at arm's length is ascertainable, that amount; and in any other case, the market value of the assets at that date. However, any gains

that may accrue to the personal representatives, or other person on whom the asset devolved, shall not be chargeable to capital gains tax. This provision applies to inheritance and does not apply to an acquisition of the business assets of a company by a person or an entity.

In relation to the acquisition of the business assets of a company by merger, takeover, acquisition or restructuring, the Companies Income Tax Act 2004 (as amended) (CITA) requires the parties to obtain clearance from the FIRS with regard to any capital gains tax that may be due on the disposal of such assets where the parties to such transaction are related parties. In giving its clearance, the FIRS will usually permit that the assets be transferred at their tax written down value, and not at their current fair market value, which will eliminate any liability to capital gains tax as the transferor would not have realised any gains from such a disposal. In addition, when granting a clearance, the FIRS may impose certain conditions such as the provision of a guarantee or security satisfactory to the FIRS for the payment of any taxes due or to become due by the company selling or transferring its trade or business. If the assets are transferred at their current market value – whether the parties are related or not, any gains realised by the transferor from that disposal will be liable to capital gains tax at the rate of 10 per cent.

### Goodwill

Under Nigerian law, gains realised from the transfer of goodwill are liable to capital gains tax. There are currently no provisions in the tax laws that allow a taxpayer to deduct or amortise the cost of acquiring goodwill. Therefore, if goodwill is subsequently disposed of by the acquiree, any gains realised will be liable to capital gains tax in accordance with the provisions of the CGT Act. Regarding depreciation, goodwill cannot be depreciated for tax purposes in the event of the purchase of the assets to which it is attached. The FIRS' position, as expressed in one of its circulars titled 'Tax Implications of the Adoption of the International Financial Reporting Standards (IFRS)' 2013, is that goodwill impairment charged to the income statement shall be disallowed for tax purposes; goodwill acquired shall not form part of the qualifying capital expenditure on which capital allowances can be claimed on an asset; and capital allowances shall not be granted on purchased goodwill. Gains arising from the disposal of a cash-generating asset with goodwill will be subject to capital gains tax. In addition, gains or losses made from the disposal of a cash-generating asset or subsidiary with goodwill component will be subject to capital gains tax in the hands of the parent company, but where the acquisition is fully share based (ie, the acquisition of shares in an asset owning company) there shall be no tax implication other than stamp duty (see question 1).

### Intangible assets

The FIRS permits the cost of acquiring intangible assets that meet the requirements of qualifying capital expenditure (ie, wholly, exclusively, necessarily and reasonably incurred in the purchase of the asset) to be capitalised and depreciated during the useful life of the intangible asset. For instance:

- software that forms an integral part of a computer will be treated as qualifying plant expenditure while stand-alone software will be treated as an intangible asset and the cost shall be amortised over the useful life of the asset;
- the cost of acquiring a customer list acquired as an intangible asset and used to generate taxable profit for the company shall be tax deductible through amortisation over the useful life, but if the intangible assets have an indefinite life then no tax deduction would be allowed; and
- the cost of a franchise shall be expensed over the useful life of that franchise. In relation to capital gains tax, gains realised from a disposal of intangible assets shall be liable to capital gains tax.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

#### Shares

With fairly limited exceptions, foreign registered companies are permitted to hold up to 100 per cent of the shares in Nigerian companies. These exceptions relate to companies operating in the oil and gas, engineering and advertising sectors of the Nigerian economy, where

Nigerians are required to hold a majority interest, and also in relation to companies that are engaged in the production of arms, ammunition, narcotic drugs and psychotropic substances, where foreign companies are not permitted to have any shareholding at all. Therefore, if an acquisition will only be of shares in a Nigerian company, it is preferable to set up an acquisition company in a foreign jurisdiction. In that case, the dividends payable to such a foreign company will only be liable to a withholding of tax in Nigeria and the tax withheld, when remitted to the FIRS, will be the final tax due on that income in Nigeria in the hands of the foreign investor. On the other hand, if the share acquisition company is set up in Nigeria, any dividends received by the acquisition company from the target company would be franked investment income and would not be subject to the imposition of companies income tax as part of the profits of the acquisition company. Where the acquisition company is to pay out the dividends received from the target to its shareholders (ie, redistributed), and where the acquisition company would be required to account to the relevant tax authority for the tax it is required to withhold from such dividends, the acquisition company may set off any tax withheld by the target company before the target company paid the dividend to the acquisition company against the amount of tax that the acquisition company has to remit to the relevant tax authority. Although any dividend that the acquisition company receives from the target company will be franked investment income and, therefore, not liable to further tax, the CITA provides that where a dividend is paid out by the acquisition company as profit on which no tax is payable due to no total profits, or total profits that are less than the amount of dividend that is paid, the acquisition company shall be charged to tax at the rate of 30 per cent as if the dividend paid is the total profits of the acquisition company for the year of assessment to which the accounts, out of which the dividend is declared, relate. What this means is that the CITA imposes what, for want of a better term, can be described as an 'excess dividend tax'. It is this excess dividend tax that makes it not tax efficient to set up the acquisition company in Nigeria.

It is also preferable for an acquisition company to be established outside Nigeria and in a country that has a double tax treaty with Nigeria. This is because the dividends payable to the non-resident company will be subject to the withholding of tax at a reduced rate of 7.5 per cent instead of 10 per cent.

### Business assets

An acquisition of business assets must be executed by an acquisition company incorporated in Nigeria. This is because under section 54 of the Companies and Allied Matters Act 2004 (CAMA), any foreign company that seeks to carry on business in Nigeria is required to take steps to incorporate as a separate entity in Nigeria. The ownership of business assets in Nigeria by a foreign entity would, in our opinion, be deemed to be doing business in Nigeria. Therefore, if a foreign registered company acquired business assets in Nigeria without incorporating a subsidiary in Nigeria, that would breach the above provision. The section further provides that any act done in contravention of the provision shall, among other things, be void.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

The acquisition of shares in a Nigerian company is the most common form through which acquisition transactions are carried out in Nigeria. This is because, as we have indicated in our response to question 1 above, any gains realised from a disposal of shares are not liable to capital gains tax. Mergers are also sometimes used to acquire the business assets of another entity. With clearance from the FIRS, a merger can also help parties eliminate the payment of capital gains tax and stamp duties in appropriate cases. In addition, the exchange of shares pursuant to a merger is also not liable to capital gains tax. However, if the business assets include land held by the company that will be dissolved following the merger, registration fees will be paid to register the surviving entity as the owner of that land at the relevant state's land registry. Furthermore, the merging entities will need to obtain the approval of the Securities and Exchange Commission and an order of the Federal High Court sanctioning the merger.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

There are no tax implications if the consideration paid in a share acquisition transaction is shares instead of cash. In relation to the acquisition of business assets, there are also no tax implications to the acquirer in issuing stock as consideration (rather than cash) in the acquisition of business assets. This is because if the acquisition is in relation to shares, any gains made will not be liable to tax regardless of how the consideration is paid by the acquirer. On the other hand, if the acquisition is of business assets, then the applicable taxes will still be due, regardless of the form that the consideration takes.

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

As already indicated in our response to question 1, stamp duty and VAT (where applicable) are payable on the agreements and consideration for the acquisition of business assets while capital gains tax is payable on any gains realised by the seller from such disposal of business assets. These taxes will be eliminated if the acquisition is done through a merger sanctioned by the court and cleared by the FIRS. No VAT or capital gains tax is payable on the acquisition of stocks. Although exempted from stamp duty, parties will usually stamp share transfer forms at a nominal rate while the stamp duty payable on a share sale and purchase agreement can only be conclusively determined following an assessment of the document by the Commissioner. Stamp duty is payable by the purchaser of the business assets while capital gains tax on any gains is payable by the seller. Although VAT is payable by the acquirer of the assets, the seller has the statutory obligation to collect the tax from the buyer and remit same to the FIRS with the exception of a purchaser operating in the Nigerian oil and gas sector, which has an obligation to withhold the VAT and remit to the FIRS.

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Net operating losses, tax credits or other types of deferred tax assets are generally not subject to any limitations after a change of control of the target or in any other circumstances except in insolvency. However, under Nigerian law, the net operating losses made by a company (except agricultural companies) within the first four years from the date of commencement of business can only be carried forward for another four years while losses incurred by a company thereafter (and those of agricultural companies) are permitted to be carried forward indefinitely until fully absorbed by the company from its future profits. With regard to companies involved in insurance business, losses incurred in any year of assessment can only be carried forward for a maximum period of four years (from the year of assessment when the insurance company incurred the losses) after which such losses would lapse. Any impairment losses charged to a company's income statement are not allowed for tax purposes. Where a company becomes insolvent and it is wound up, the losses shall cease.

Operating losses, tax credits or other types of deferred tax assets can be preserved through a merger of the entity that holds the tax assets with another entity. Where the surviving entity carries on the business of the entity with the tax assets (ie, the dissolved entity), the surviving entity will be entitled to utilise the tax assets post-merger.

An acquisition or reorganisation of a bankrupt or an insolvent company is not subject to any special rules or tax regimes under Nigerian law.

## 8 Interest relief

### Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

#### Interest

There are no specific interest reliefs available to parties that have taken on borrowings in connection with an acquisition. In the event, however, that an acquisition company is a Nigerian company that has obtained a foreign loan in a foreign currency for the acquisition, and that loan meets both the moratorium and tenor requirements prescribed in the CITA, the interest payments on such a loan may be partly or wholly exempted from the withholding of tax. A 'foreign loan', for purposes of the CITA, is one: granted to a Nigerian company by a foreign company using funds that the foreign company brought into Nigeria from any territory outside Nigeria or any loan granted to a Nigerian company by that foreign company in any territory outside Nigeria; and granted in a currency other than the Nigerian currency. The tax exemptions applicable to foreign loans are as follows:

Repayment period including moratorium	Grace period	Tax exemption allowed
Above seven years	Not less than two years	100 per cent
Five to seven years	Not less than 18 months	70 per cent
Two to four years	Not less than 12 months	40 per cent
Below two years	Nil	Nil

This incentive is, strictly speaking, not an incentive for the acquisition company but is an incentive for the foreign lender. What it means is that where an acquisition company has an obligation to gross up interest payments to a lender on account of the tax required to be withheld from such interest, the acquisition company will have no obligation to do so (ie, to gross up the interest payment) if the terms of the loan agreement meet the tenor and moratorium requirements of the CITA.

There are generally no restrictions on the deductibility of interest, regardless of whether the lender is a foreign company, a related party, or both. Where the lender is a related party, however, the FIRS transfer pricing rules require that the rate of interest should reflect the rate at which the borrower should have been able to obtain a similar loan on transactions entered into on an arm's-length basis. Where the FIRS determines that the rate of interest agreed by the parties does not satisfy the arm's-length test, it will disregard the rate agreed to by the parties, impose a rate that it thinks the borrower should have been able to obtain the loan in a transaction entered into at arm's length, and impose tax on the borrower accordingly.

Unless a lending transaction comes within those specifically exempted from tax, the requirement to withhold tax on interest payments, and to remit the tax withheld to the relevant tax authority, cannot be avoided.

#### Debt pushdown

Debt pushdown can be achieved through a merger of a borrower and another company, provided such pushdown does not result in the target company providing 'financial assistance' to the borrower. This is because under the provisions of CAMA, it is unlawful for a company to give financial assistance (which includes a gift, guarantee, security or indemnity, loan, any form of credit and any financial assistance given by a company), directly or indirectly, for the acquisition of its own shares. There will be financial assistance if the borrower had used the loan that is sought to be 'pushed down' to the other company to acquire shares in the company that the debt is being pushed down to.

There are currently no applicable thin capitalisation rules that would prevent the pushdown of excessive debt in Nigerian companies. However, some sector-specific regulators (such as the banking and insurance regulators) may object to the pushdown of excessive debt into the entities that they regulate.



## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

The forms of protection that parties generally seek and obtain in most stock and business asset acquisitions include representations, undertakings, warranties and indemnities. We have also seen parties enter into a deed of tax covenants. These are usually documented in the acquisition and transaction agreements.

There is no requirement to withhold taxes on payments made in respect of claims for breach of warranties or under indemnities. If the recipient of payments in respect of such claims is a Nigerian company, such payments will, however, be taxable as income in the hands of such a recipient at the applicable rates.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

A scheme of merger, scheme of arrangement or reduction in share capital are the post-acquisition restructuring mechanisms that we typically see used by companies in Nigeria. The type of post-acquisition restructuring and the mechanisms to be adopted by a company will depend on the circumstances of each company and the objective that its management intends to achieve. For instance, the rationale for a post-acquisition restructuring may range from the need for capital reconstruction or reconstitution, to streamline a company's structure for efficient management and reduction of cost, to eliminate or minimise tax leakages, or to comply with a regulatory requirement.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Other than a spin-off that is executed through an acquisition of shares, there is no other method to execute a completely tax neutral spin-off of businesses under Nigerian law. The available spin-off arrangements (such as a scheme of merger and a scheme of arrangements) can only help to minimise the applicable taxes and fees. In relation to any arrangement (by a merger, transfer, takeover or restructuring) that involves a transfer of business assets to another company, the CITA requires the company that wishes to transfer its assets to another company to obtain a clearance from the FIRS in relation to the capital gains tax that may be due on any gains realised from a disposal of such assets. As we have already indicated above, in giving its clearance in respect of related party transfers, the FIRS will usually permit that the assets be transferred at their tax written-down value, and not at their current fair market value. Where this is the case, it will eliminate any capital gains tax liability as the transferor would be deemed not to have realised any gains from a disposal of the assets. However, notwithstanding that the transfer may be between related entities, if the assets are transferred at their current fair market value, capital gains tax will be paid on any gains realised by the transferor on such disposal.

Where a spin-off is executed through the contractual acquisition of business assets, one of the ways to mitigate any capital gains tax liability is through a rollover relief. Rollover relief is available to any company that has sold its business assets and used the whole proceeds to acquire new assets (or an interest in new assets) to be used for the purposes of the trade in replacement of the old assets. What this means is that if any gains were realised from the disposal of the assets, there will be no obligation to pay capital gains tax on such gains. However, a company will only be entitled to claim a rollover relief if the new assets (or interest therein) are acquired, or an unconditional contract for the acquisition is entered into, within the period beginning 12 months before, and ending 12 months after, the disposal of the old assets. The consideration that has been applied to acquire the new assets will be

## Update and trends

On 17 August 2017, Nigeria became a signatory to the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting and the Multilateral Competent Authority Agreement for the Common Reporting Standard (MCAA). This is with a view to address, among other things, tax avoidance and evasion, limit abuse of treaty and other forms of tax avoidance, help the government in the fight against corruption, etc by persons – resident and non-resident – doing business and liable to pay tax in Nigeria. The signing and implementation of these instruments is expected to also allow the Nigerian tax authorities to automatically receive financial information on Nigerian nationals or companies who have financial dealings and bank accounts in any of the countries that are signatory to the treaties.

Further to the above, government (through the FIRS) recently released the Income Tax (Country-by-Country Reporting) Regulations 2018 (the Regulations), which set out the framework for the automatic exchange of country-by-country reports in accordance with the MCAA. The effective date of the Regulations is 1 January 2018. The Regulations seek to provide guidance to Multinational Enterprises on their reporting obligations to the FIRS with respect to their global economic activities. It is also hoped that the Regulations will help to prevent tax evasion or avoidance through base erosion and profit shifting.

treated for the purposes of capital gains tax as if the consideration for the disposal of the old assets were (if a greater amount or value) of such amount as would ensure that on the disposal neither a loss nor a gain accrues to the seller, and as if the amount or value of the consideration for the acquisition of the new assets were reduced by the excess of the amount or value of the actual consideration for the disposal of the old assets over the amount of the consideration that the seller is treated as receiving. The rollover relief shall not apply if only part of the amount or value of the consideration for the disposal of the old assets is applied to purchase the new assets. However, if all of the amount or value of the consideration except a part of it that is less than the amount of the gain (whether chargeable gain or not) accruing on the disposal of the old assets is to be applied to purchase the new assets, then the rollover relief shall apply. The relief will also not be available if the proceeds realised from a disposal are not used to purchase new assets (or an interest in new assets) or are used to purchase new assets outside the prescribed period permitted by law.

Regarding losses, under Nigerian law, losses do not pass with the business assets under a contractual asset sale. Losses will remain with the seller as its tax assets. In the case of a merger, the surviving entity could inherit the unabsorbed losses and capital allowances of the merged companies if it is proved that the new business is a reconstituted company. Therefore, where a reconstituted company is carrying on the same business previously carried on by the company that it has merged with, and it is proved that the losses have not been allowed or utilised against any assessable profits or income of the other company for any previous year, in that case the amount of unabsorbed losses shall be deemed to be losses incurred by the reconstituted company in its trade or business during the year of assessment in which the business commenced.

A spin-off of business assets carried out through a scheme of arrangement or merger approved by the court will not trigger transfer taxes such as VAT and stamp duties. However, if the business assets include land, registration fees will be paid to have the land registered in the name of the surviving entity. On the other hand, a contractual spin-off of business effected through the acquisition of shares in the company that owns the assets will not trigger any transfer taxes.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

Under Nigerian law, it is not possible to change the residence of a company incorporated in Nigeria to another jurisdiction.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Nigerian tax laws provide for the withholding of tax on interest and dividend payments due to any person or company (whether or not resident in Nigeria), unless such payments are specifically exempted from tax. The rate at which tax is withheld from dividends and interest is 10 per cent. Where the recipient of the dividend or interest is resident in a country with which Nigeria has entered into a double taxation agreement, the rate at which tax will be withheld from the dividend or interest is reduced from 10 per cent to 7.5 per cent. Nigeria currently has effective double taxation treaties with the United Kingdom, Belgium, Canada, China, the Czech Republic, France, the Netherlands, Pakistan, the Philippines, Romania, Slovakia, Spain and South Africa.

In the case of a non-resident individual or company or a Nigerian resident individual, the tax withheld from dividend and interest payments shall, when remitted to the relevant tax authority, be regarded as the final tax due on that income from such non-resident individual or company or Nigerian resident individual. Taxes are required to be withheld and remitted in the currency of a transaction. In relation to a recipient that is a Nigerian company, the dividends would be franked investment income and such income would not be treated as part of its profits for companies income tax purposes. Where the recipient company is to pay out the same dividends to its shareholders (ie, redistributed), and where the recipient company would be required to account to the relevant tax authority for the tax it is required to withhold from such dividends, the recipient company may set off any tax withheld by the company that initially paid the dividend against the amount of tax which the recipient company has to remit to the relevant tax authority.

Certain dividend and interest payments are exempted from tax. These include dividends paid by oil and gas exploration companies, as well as dividends paid by companies that have been granted 'pioneer status' (ie, a tax-exempt status granted to Nigerian companies that are engaged in certain businesses). Interest payments on foreign loans that have a term of at least seven years plus one day and a grace period on the payment of principal and interest are also wholly exempt from tax and so is the interest earned on Nigerian government bonds and treasury bills, and the interest on corporate bonds. Similarly, any interest or dividend that is received by a Nigerian company or individual from offshore sources, and brought into Nigeria through a Nigerian bank, is exempted from tax.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

There are various methods of extracting profits from Nigeria with minimal or reduced taxes within the ambit of existing tax laws. For example, a foreign shareholder may put minimal equity in a company and fund

the company's operations with shareholder loans. If such a loan meets the requirements as discussed in question 8, the interest payment may be partly or wholly exempt from the withholding of tax. In addition, the interest payment on that loan will be a deductible expense for the company. A foreign shareholder could also invest in a Nigerian company (by debt or equity investment) through an entity incorporated in a country with which Nigeria has entered into a double taxation agreement. The rate at which tax will be withheld on any interest or dividend payments to such a company will be reduced from 10 per cent to 7.5 per cent. Another option would be for a shareholder to invest in companies that have certain tax incentives such as a company that has been granted a pioneer status certificate or in a gas utilisation company. Such company will have a corporate tax exemption of up to five years, favourable treatment in respect of capital allowances and any dividend distributed by a pioneer company within the pioneer period will not be liable to a withholding of tax. In addition to the above, gains realised from a disposal of shares will also not be liable to capital gains tax.

### Disposals (from the seller's perspective)

#### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Depending on the nature of the arrangements and on how a company is structured, the disposal of businesses is usually carried out through a contractual sale of the business assets, sale of the stock in the local company that owns the business assets, or sale of the stock in the local or foreign parent company of the Nigerian company that owns the assets.

#### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Any gains realised by a non-resident company from the disposal of stocks in a Nigerian company will be exempt from tax in Nigeria. This is because the tax exemption applicable to any gains realised from a disposal of shares applies to both resident and non-resident shareholders.

Although there are no special rules in relation to taxes while dealing with the disposal of stocks in a company engaged in the business of energy and natural resources, if the disposal of the stocks is in an oil and gas exploration and production company then, depending on the proportion of the shares that are to be sold, such a disposal will require the consent of the minister in charge of petroleum resources. There are also no special rules that are applicable to the disposal of stocks in a company that is engaged in real property business.



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**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

As we have already indicated above, there is no tax in Nigeria on gains realised from a disposal of shares. In relation to a contractual disposal of business assets, there is a rollover relief in respect of capital gains tax if the proceeds of the disposal are used to purchase new business assets to replace those disposed of. Another method is to obtain a clearance from the FIRS, but this will require that the assets be transferred at their tax written down value. See question 11 for details.

# Norway

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

From the perspective of the purchaser, there are several important differences between structuring an acquisition as a share transaction and an asset transaction.

Firstly, acquiring the shares of a target company does not affect the tax depreciation bases of the target company's assets. The purchase price would be allocated in full to the acquired shares, and no goodwill would be recognised for tax purposes. Conversely, when acquiring the business assets and liabilities directly, the purchaser would recognise new tax bases on the acquired (tangible and intangible) assets and liabilities. Goodwill recognised as a result of the asset transaction is depreciable for tax purposes. For further details see question 2.

Secondly, when structuring an acquisition as an asset transaction, historical tax liabilities (and historical tax assets, such as tax losses carried forward) generally remain with the seller. In a share transaction, the purchaser effectively assumes liability for all historical tax risk, which remains with the target company. This starting point can be adjusted in agreements between the parties, to arrive at an appropriate allocation of liability (see question 9).

The special tax regimes applicable for companies in the oil and gas (exploration and production) and hydropower industries provide for 'tax neutral' asset transfers in certain circumstances.

Finally, asset transactions may trigger transaction taxes (see question 6). The sale and purchase of shares, on the other hand, does not trigger any indirect taxes for either seller or purchaser.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

A step-up in the tax depreciation bases of the business assets and liabilities is generally only available in an asset transaction. Goodwill recognised in the transaction (very broadly, the difference between the purchase price paid and the fair market value of identifiable tangible and intangible assets) would be depreciable for tax purposes at 20 per cent per annum on a declining balance basis. Agreements between the parties with respect to the allocation of the purchase price (which could significantly affect the taxation of both seller and purchaser) are not binding on the tax authorities. Purchase price allocation studies are therefore usually prepared to support the allocation between the different types of assets and liabilities acquired.

When acquiring shares, it is not possible to 'push' the purchase price paid for the shares in the target company down onto the underlying assets and liabilities. No goodwill is recognised for tax purposes. The goodwill arising on consolidation for accounting purposes (assuming a Norwegian purchaser) is disregarded for tax purposes (as the

purchasing company would be taxed on a standalone, rather than consolidated basis).

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Non-resident purchasers typically set up local acquisition vehicles when acquiring Norwegian companies or businesses, but this should be considered on a case-by-case basis, taking into account both tax and other effects.

From a tax perspective, the ability to offset financing expenses against taxable income would typically be an important consideration. As Norway does not allow for cross-border consolidation, offsetting financing expenses against the profits of the Norwegian target company would not be possible unless the acquisition debt is drawn down locally. This is typically arranged through a Norwegian acquisition company.

There is no tax grouping, fiscal unity or similar arrangements under Norwegian law. A degree of consolidation for tax purposes may be achieved using group contributions. A group contribution is a deductible and taxable transfer of taxable profits from one company to another. The two must be part of the same qualifying group (more than 90 per cent of capital and voting rights). The group contribution is an actual transaction, as opposed to a notional shift of profits for tax purposes, and requires a transfer of funds (or leaving the amount unsettled as receivable or payable). As a main rule, the group contribution requires distributable reserves.

Dividends from the target to the Norwegian acquisition company should be exempt from Norwegian taxation (3 per cent of the exempt dividend is added back to the taxable income unless the acquisition company holds more than 90 per cent of the shares), and there should generally be no adverse implications on exit. In the event the non-resident shareholder does not qualify for a dividend withholding tax exemption (see question 13), partial exits may in certain circumstances be complicated, as the Norwegian holding company would not be able to remit proceeds in the form of dividends without triggering Norwegian tax. It should generally be possible to address this issue by appropriate structuring steps.

In certain situations, it may be preferable to acquire the target company or business directly. For example, the withholding tax exemption for dividends distributed by companies engaging in activities subject to the special Petroleum Tax regime (see question 13) only applies to direct distributions. In the event dividends are passed up through a Norwegian holding company, the exemption would not apply on the distribution out of the holding company. In the context of an asset transaction, it may in some cases be preferable to operate the target business through a branch, as there is no branch profits tax (or similar), whereas dividends might trigger Norwegian withholding tax (see question 13).

Norwegian companies are always taxed in Norwegian kroner, irrespective of functional currency. It is not possible to make a designated currency election. If acquisition financing is drawn in a currency other than kroner, currency gains or losses would generally be taxable deductible. As a main rule, it should be possible to defer recognition of gains or losses until realisation (eg, downpayment or refinancing).



#### 4 Company mergers and share exchanges

##### **Are company mergers or share exchanges common forms of acquisition?**

Company mergers or share exchanges are rarely used to effect acquisitions. While either alternative could in principle be structured in a tax-neutral manner, they severely restrict a seller's ability to exit the investment.

Norwegian company law does not allow for all-cash mergers. No more than 20 per cent of the total consideration can be assets (including cash) other than shares issued by the acquiring company (or, in certain circumstances, another Norwegian company in the acquiring group). This means that the merger-option is generally unattractive for a seller that wishes to exit more than 20 per cent of its investment.

Share-for-share exchanges have historically been treated as ordinary fair market value disposals for Norwegian tax purposes. When Norway introduced rules allowing for tax-neutral cross-border mergers, specific provisions concerning tax-neutral share-for-share exchanges were also included. Curiously, no corresponding provisions have been included in a purely domestic context. As such, it is not possible to implement a tax-neutral share-for-share exchange where both the acquiring and target company are Norwegian.

If the acquiring company is genuinely established (see question 13) in another EEA member state, a share-for-share exchange can be implemented on a tax-neutral basis. At least 90 per cent of the shares issued by the target company must be acquired by the acquiring company. In addition, as with mergers, no more than 20 per cent of the total consideration can be assets other than shares in the acquiring company. The requirement that the acquiring company be non-Norwegian complicates the position with respect to obtaining local acquisition financing.

A share-for-share exchange could also be carried out on a non-neutral basis. In the event the seller is a qualifying Norwegian corporate, or non-Norwegian, gains realised on the disposal should be tax exempt.

#### 5 Tax benefits in issuing stock

##### **Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

There is no tax benefit to the acquirer in issuing stock as consideration rather than cash, other than derivative benefits of structuring the transaction as a tax neutral share for share exchange or merger, as discussed above.

#### 6 Transaction taxes

##### **Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

The acquisition of real estate is subject to a 2.5 per cent ad valorem stamp duty when the transfer of the right of ownership is registered. Asset transactions might trigger VAT, but an exemption is generally available when transferring a business (or part of a business) as a going concern.

The transfer of shares is exempt from VAT. No other indirect taxes apply.

#### 7 Net operating losses, other tax attributes and insolvency proceedings

##### **Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

As a main rule, a target company's tax assets (including tax losses carried forward) are not affected by transactions in the company's shares. There are no general provisions ring-fencing tax assets, restricting their use to profits from the legacy business, or similar.

Norway has a statutory anti-avoidance rule, as well as a general anti-avoidance standard developed by the courts. The statutory

anti-avoidance rule targets transactions (whether by way of merger, share-for-share exchange, or ordinary acquisition) primarily motivated by the utilisation of the target company's tax assets. The assessment of what has motivated the transaction should be based on objectively verifiable factors. All facts and circumstances that might shed light on the purchaser's motivation should be taken into account, and the rule does not operate on a purely mathematical basis. That said, the relative size of the potential tax benefit compared with the value of the target company as a whole would typically provide an indication of the risk of the rules being in point.

As a general rule of thumb, the statutory anti-avoidance rule should not be applicable where the acquisition does not result in any increased possibility of utilising the tax assets. Where the purchaser has no other Norwegian group companies that might access the losses using group contributions, the anti-avoidance rule should generally not be applicable. In this scenario, the losses are effectively only available to offset future profit in the same business in which they arose. However, this must be assessed on a case-by-case basis. If, for example, a material change in the nature (or outright discontinuance) of the company's business takes place post-acquisition, this might indicate that the losses, rather than the business itself, was the main purpose driving the acquisition.

If a company enters into arrangements with its creditors for the waiver or forgiveness of debt, (a portion of) tax losses carried forward would normally be forfeited (on a kroner for kroner basis).

#### 8 Interest relief

##### **Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Financing expenses (interest and equivalent costs) are deductible on an accruals basis. No distinction is made with reference to the application of the borrowed funds; interest on debt drawn down to fund the acquisition of shares, the income from which is typically tax exempt, is in principle deductible.

An 'earnings-stripping' rule applies for taxpayers with net financing expenses exceeding 5 million kroner, capping the deductibility of net financing expenses on 'related party debt' to 25 per cent of earnings before interest, taxes, depreciation and amortisation (tax EBITDA). Broadly, the tax EBITDA is calculated by taking the company's taxable income (after receipt or surrender of group contributions, and the use of tax losses) and adding back net financing expenses and tax depreciations.

The rules apply on a single entity basis, and it is not possible to transfer excess capacity to deduct interest within a group. However, as group contributions received would be included in the tax EBITDA, taxable income could be transferred from companies with excess capacity to companies with a shortfall of tax EBITDA, in order to maximise the effective relief available to a tax group. A holding company without any business activities of its own might therefore be able to claim relief for (a portion of) its financing expenses if it receives group contributions from its subsidiaries. Note that group contributions are made out of taxable income, after net financing expenses and tax depreciations. If a group company has low taxable profit, but high taxable EBITDA as a result of tax depreciations, it might have high capacity to claim deductions for financing expenses, but this capacity would effectively be stranded.

The definition of 'related party debt' is very broad. It covers ordinary control (at least 50 per cent direct or indirect ownership), back-to-back arrangements through third parties, as well as third-party debt if guaranteed by a related party (specific exceptions apply). While it is only financing expenses on related party debt that would be disallowed, all financing expenses count towards the 25 per cent threshold. Accordingly, if the taxpayer's financing expenses on pure third-party debt exceed 25 per cent of taxable EBITDA, the taxpayer would still be able to claim relief for such financing expenses, but there would be no headroom for deducting any financing expenses on related party debt.

Disallowed interest expenses may be carried forward for up to 10 years.

The Ministry of Finance has announced it is working on a legislative amendment that would extend the application of the earnings stripping rules to all interest expenses (including pure, non-guaranteed third-party debt). The stated aim is that the amendment would be effective for financial years ending on or after 1 January 2019. An extension would likely include a 'Group Ratio' type of escape clause, allowing deductions if the ratio of debt to assets, interest expense to EBITDA, or other ratio to be determined of the Norwegian subgroup is equal to or lower than that of the worldwide group. The details are not known at the time of writing, but a formal proposal is expected in the near term.

Finally, general arm's-length transfer pricing principles apply with respect to interest rate and capitalisation (debt-to-equity ratio). Norway follows the principles set out in the OECD Transfer Pricing Guidelines.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Purchasers would normally look to include relevant protection mechanisms in the sale and purchase agreement. The nature and scope of protection would depend on the negotiations between the parties, as well as the potential exposure identified in the due diligence procedures. Typically, the purchaser would look to obtain protection covering all financial years open to re-assessment, and tax claims are therefore typically regulated separately in terms of provisions limiting seller's liability.

In the context of a share transaction, the sale and purchase agreement would typically include warranties (which the seller might disclose against), and indemnities. Full tax deeds are often observed where the purchaser is non-Norwegian (in particular from a common law jurisdiction), but less frequently so in a purely Norwegian context.

Warranty and indemnity insurance has also become more common. With recent legislative amendments extending the general statute of limitations for re-assessment to five years, this trend appears likely to continue.

The tax treatment of payments under warranties or indemnities depends on how the agreement regulates such payments. Normally, the agreements provide that such payments should be an adjustment to the purchase price. The payments should therefore not be taxable in the hands of the purchaser (although they may reduce depreciation bases on tangible and intangible assets in the context of an asset deal).

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

What post-acquisition restructuring steps might be required, or desirable, depends on the position of both the target company and the purchaser.

#### Refinancing

Depending on the financing arrangements of the target company or group, and the agreement with the sellers, the target company's debt may require refinancing. This might provide an opportunity for placing debt directly into the target, allowing debt service directly out of underlying operational cashflows. Non-tax considerations (such as the company law rules on financial assistance) should be duly considered.

#### Supply or value-chain restructuring

Efficiencies may be available to the purchaser in altering supply chains, or changing the nature of the target's business operations (eg, from a buy or sell distributor to a limited risk distributor). Transfer pricing considerations and exit taxes should be considered if assets, functions, or risks are transferred out of Norway.

### Spin-off of non-core functions

The target company or group may hold assets or functions the purchaser would have preferred not to have acquired, or that do not fit into the purchaser's future plans for the business. Such assets or functions can be disposed of directly, or spun off in a demerger (see question 11).

### Elimination of double functions

There may be synergies available to the purchaser in having certain functions of the target business carried out by a comparable function in the purchaser group. Transfer pricing considerations and exit taxes should be considered if assets, functions or risks are transferred out of Norway.

### Legal entity reduction

The target company may be part of a group with an excessive number of legal entities, which may typically complicate operations (requiring a number of intra-group transactions and agreements), and drive compliance costs. Mergers can generally be carried out on a tax-neutral basis.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Tax-neutral spin-offs may be carried out through a demerger or a tax-neutral intra-group transfer of assets.

Tax-neutral intra-group transfers are rarely used in the context of acquisitions or disposals, as the tax deferred would become due when the transferor and transferee cease to be part of the same group (more than 90 per cent ownership and control). This applies irrespective of the amount of time that passes between the transfer and the breaking of the group.

A demerger entails 'splitting' a company in two (or more) separate companies. The shareholders of the original company would receive shares in the new companies as consideration. Norwegian law provides for tax-neutral demergers, carried out in accordance with principles of fiscal continuity (very broadly, no step-up of tax bases, all unrealised gains or losses deferred). Tax losses (as well as other tax positions) relating to the transferred assets or functions would transfer over to the new company (subject to anti-avoidance considerations, where relevant). A tax-neutral demerger should not trigger any transaction taxes.

Because a direct sale of assets would normally be a taxable transaction, while the sale of shares is typically exempt (for qualifying shareholders), taxpayers have had an incentive to structure disposals by way of demerger and sale of shares (there is no statutory holding period post-demerger). The tax authorities have historically challenged such transactions using the general anti-avoidance standard developed by the courts. Such challenges were frequently successful, in particular where the demerger took place in direct connection with a planned transaction. However, when the question was put before the Supreme Court in the *ConocoPhillips/Tangen 7* case, the court ruled in favour of the taxpayer.

Demergers are technically complex exercises, and errors may result in the transaction becoming taxable. Obtaining professional advice is therefore strongly recommended.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

The migration of tax residency would trigger the deemed disposal for tax purposes of the migrating company's assets and liabilities.

If the migrating company becomes 'genuinely established' in an EEA member state (see question 13 for more detail), there would be no general deemed disposal. However, exit taxes may be due with respect to assets, functions, or risks taken out of the Norwegian tax jurisdiction. Hence, if the company retains a Norwegian permanent establishment that carries on the business activities of the company, it should be possible to effect a migration for tax purposes without triggering Norwegian taxation. The payment of exit taxes may be spread over seven annual instalments. Interest would accrue on the unpaid amount.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

#### Interest

There is currently no withholding tax on interest payments made by Norwegian tax residents. The Norwegian Ministry of Finance has indicated that it is working on a proposal for the introduction of withholding taxes on interest and royalties, but no draft or consultation papers have been released to date.

Norway has concluded tax treaties with approximately 90 countries, many of which allocate the right to tax interest payments to the state of residency (subject to the creditor satisfying a beneficial ownership test).

#### Dividends

As a main rule, dividends from Norwegian companies to a foreign shareholder are subject to 25 per cent withholding tax.

Two exemptions may apply under domestic law. Firstly, dividends distributed to a qualifying shareholder resident in an EEA member state (the European Economic Area is the EU countries plus Iceland, Liechtenstein and Norway) should be exempt from withholding tax. A qualifying shareholder is one that has a legal form equivalent to a Norwegian qualifying shareholder, and is 'genuinely established, and carries out genuine economic activities' in an EEA member state.

Very broadly, qualifying legal forms should include most entities that would be considered fiscally opaque under Norwegian tax principles. There is no 'white list' of approved legal forms, meaning each case must be considered on its own merits. The key point in this context is whether any member or shareholder of the entity has unlimited liability for the obligations of the entity (which would normally result in the entity being considered fiscally transparent). On that basis, most limited companies (eg, German GmbHs, Swedish Aktiebolag, UK Ltds, Luxembourg Sarls) should qualify. Other entities, including collective investment vehicles, pension schemes and life insurance undertakings should be considered on a case-by-case basis.

The 'genuine establishment and genuine economic activity' criterion is based on the *Cadbury Schweppes* line of case law from the Court of Justice of the European Union, providing that EU (and EEA) member states can apply discriminatory measures provided they relate to 'wholly artificial arrangements' set up to escape the national tax otherwise due.

There are two essential elements to the test. The first is whether there is an intention to obtain a tax advantage. This is in itself not decisive, as EEA member states are not allowed to maintain discriminatory measures in order merely to safeguard their tax base. Without an identifiable tax saving, however, there cannot be a wholly artificial arrangement entered into for the purposes of obtaining a tax benefit. This has also generally been accepted by the Norwegian tax authorities.

The second element is a test of whether there are objective circumstances which demonstrate that despite the arrangements formally qualifying for the grant of a tax exemption, the objectives pursued by the EU or EEA freedom of establishment (or capital, as the case may be) has not been achieved. While each case is assessed on its own merits, the following factors are typically considered relevant by the Norwegian tax authorities:

- whether the company has fixed premises at its disposal;
- whether the company has a permanent management and other employees carrying on the economic activity of the company; and
- whether employees are authorised and qualified to carry out the economic activity of the company and whether the authority is in fact used.

Holding companies and investment funds have been considered in administrative practice, but practice has been inconsistent. The main challenge is that the activities of such entities do not necessarily require a significant amount of personnel functions. It is also not fully clear how to consider situations where the entity has contractually outsourced functions to other parties (such as a manager or adviser).

When the tax authorities consider the question of genuine establishment, they tend to perform a detailed factual analysis, and the

result differs from holding vehicle to holding vehicle, depending on those factual findings. A case-by-case analysis is therefore necessary. It is possible to request binding rulings from the Norwegian tax authorities on whether a shareholder satisfies this criterion.

In addition to the general exemption, a special exemption applies with respect to dividends distributed by companies subject to the Petroleum Tax regime (tax rate of 78 per cent). The portion of a distribution coming out of profits that have been subject to Petroleum Tax (calculated on a pro rata basis) is exempt from withholding tax provided the shareholder owns at least 25 per cent of the distributing company. The exemption only applies with respect to distributions from the company subject to petroleum tax. If that company is held through a Norwegian holding company, subsequent dividends from the holding company would be considered under the general rules outlined above (ie, no track and trace mechanisms).

Norway has concluded tax treaties with approximately 90 countries, some of which allocate the right to tax dividend payments to the state of residency, subject to the shareholder satisfying a beneficial ownership test. There is limited case law and practice concerning the beneficial ownership test. As a minimum, the shareholder must be the legal owner of the shares, and bear the economic risks associated with the ownership of the shares. In this context, an important factor is whether the recipient has the right to use and enjoy the dividend unconstrained by a contractual or other legal obligation to pass the payment received on to another person.

In line with the OECD BEPS project, Norway is taking steps to implement anti-abuse measures in tax treaties. To date, the principal purpose test is the prevailing means of countering treaty shopping (although many treaties still lack this type of provision), but Norway has expressed its preference for limitation on benefits clauses, and will work to implement such clauses through bilateral negotiations.

#### Branch distributions

Remittances from Norwegian branches or permanent establishments to their head offices are not subject to withholding taxes.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Paid-in capital may under certain circumstances be returned to shareholders without triggering Norwegian withholding tax. 'Paid-in capital' in this context is a tax-specific amount, that may or may not correspond to the paid-in capital as set out in the financial statements. It is also calculated on a per-share basis, which can present challenges if the company has been funded over multiple rounds, so different shares have different paid-in capital for tax purposes attaching to them. It is important to ensure that there is sufficient paid-in capital behind each share before effecting a repayment, and professional advice is strongly recommended.

#### Disposals (from the seller's perspective)

### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Disposals are most commonly carried out as disposals of shares, which should be tax exempt for a qualifying Norwegian or a foreign shareholder. Qualifying shareholders broadly include all Norwegian corporate bodies (with the potential exception of pension schemes and life insurance undertakings, if the investment is held in the collective portfolio).

Gains realised on the disposal of assets are taxable. Depending on the nature of the asset, recognition of the gain may be deferred through the 'profit and loss account' (20 per cent recognised per annum on a declining balance basis), or reducing the tax depreciation pool for that type of asset.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax?  
Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Gains realised by a non-resident shareholder on the disposal of shares in a Norwegian company are not subject to tax in Norway. There are no special provisions concerning companies owning particular assets, or that engage in particular activities.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

There is no general tax-neutral rollover regime in Norway. Tax-neutral transactions are effectively limited to mergers and cross-border share-for-share exchanges. As outlined above, these are typically impractical in the context of an acquisition.

As gains realised on disposal of shares would be tax exempt for the majority of sellers (including Norwegian limited companies and foreign sellers), the question of neutral rollovers primarily arises in the context of private individuals that re-invest a portion of the sales proceeds, and in the context of asset transactions.

Pre-transaction structuring may in certain circumstances mitigate the tax due on disposal of assets (see question 11 concerning spin-offs). There is generally no readily available means of mitigating the tax charge due on private individuals realising gains on shares.



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# Panama

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Transfer of property under Panamanian tax laws may be subject to:

- income tax over capital gains;
- transfer taxes, depending on the type of property or assets, as further described in question 6; and
- stamp taxes on agreements signed in connection with the transaction.

An important difference between the tax treatment of an acquisition of stock and an acquisition of business assets and liabilities is that the transfer of stock involves a single tax assessment for income tax relating to capital gains. An acquisition of assets and liabilities will involve both a capital gains assessment and transfer taxes relating to the property being transferred.

Income tax from capital gains is applicable to a transfer of property including chattels, real property, and stock and securities issued by companies with taxable or local source income. Capital gains tax is set at 10 per cent. However, the criteria for assessing and collecting capital gains income tax are contingent on the type of property being transferred, as described below.

### Direct or indirect transfer of securities issued by companies with underlying economic investments in Panama

A 10 per cent capital gains tax is applicable to income deriving from a direct or indirect sale of stock or any type of securities issued by companies with economic investments within Panamanian territory. Companies that keep economic investments within and without Panamanian territory will only be taxed in Panama over the value of the investment portion located in Panama.

The capital gains tax is applicable when the stock or securities transferred are issued by a non-resident foreign company or held by non-resident individuals or companies and when the transfer takes place outside Panama.

The taxable gain is the difference between the book and sale or transfer value of the stock or securities.

Under an acquisition of stock or securities, Panamanian tax law requires buyers to retain 5 per cent of the total transfer value as an advance payment of capital gains tax. The buyer has the responsibility of forwarding the 5 per cent retention within 10 days from the date when a payment obligation arises. The buyer, the seller and the target entity or issuer of transferred stock or securities are jointly liable for any unpaid taxes.

Once capital gains tax is withheld and paid, the seller has the option to:

- consider the retained amount as the definitive income tax paid over the transaction, and take no further action; or
- request a tax credit over any amount paid in excess of the 10 per cent rate of the gains arising from the transaction. The taxpayer may elect to use any resulting tax credit to settle other tax obligations or request a tax refund within three years of the year when

the transaction and payment took place. Tax credits thus obtained cannot be assigned.

The Panamanian taxable basis of a company that maintains economic investments within and without Panamanian territory is the greater of:

- the transfer value of the portion of the equity of the legal entities that generate Panamanian source income out of the total equity subject to the transaction; or
- the transfer value of the portion of the assets economically invested in Panama from the total assets subject to the transaction.

The transfer of securities issued by a Panamanian company or through the acceptance of a public offer for the acquisition of shares pursuant to Panamanian securities law is subject to capital gains tax. However, Panamanian securities legislation creates an exemption from capital gains tax in the event of a transfer of securities registered at the Panamanian Securities Market Superintendence (SMV), provided such transfer:

- is made through an organised securities market or stock exchange; or
- results from a merger, consolidation or corporate reorganisation, and the transferring shareholder receives only stock of the subsisting entity, or an affiliate of the same, as consideration. Nevertheless, the subsisting entity may pay up to 1 per cent of the value of stock issued to the receiving shareholder in cash or other assets to prevent dividing the stock into fractions.

The following transfers of securities are exempted from capital gains tax:

- transfers where the government is the acquirer;
- transfers between parents and children and between spouses; and
- court-ordered transfers.

Transfers of stock or securities that do not generate gains are not subject to capital gains tax. Where a transfer does not yield a gain, the taxpayer must file an application with the tax authority. The application will require the taxpayer to submit evidence of the tax-neutral transfer. The tax authority will review the taxpayer's application and supporting evidence and may order an audit.

Under double taxation treaties (DTTs) approved and ratified by Panama, a foreign transferor of stock or securities of a company with underlying economic investments in Panama may be taxed in Panama for capital gains stemming from the transfer. To levy Panamanian capital gains tax over a transfer of securities, DTTs generally require that the foreign transferor meet threshold participations and a minimum holding period of the target entity. A minimum capital gains tax rate of 5 per cent of the gross transfer price or 10 per cent of the capital gains is also included in certain DTTs signed by Panama.

The current position in relation to DTTs is as follows:

- Panama has subscribed to and ratified DTTs with Barbados, the Czech Republic, France, Ireland, Israel, Italy, Luxembourg, Mexico, the Netherlands, Portugal, Qatar, Singapore, South Korea, Spain, the United Arab Emirates and the United Kingdom (the DTT with Italy has not yet come into force);
- Panama has negotiated DTTs with Austria, Bahrain, Belgium, Colombia and Vietnam; and

- Georgia, Greece, Poland and Switzerland have all expressed interest in negotiating DTTs with Panama.

Transfers of stock and securities of Panamanian companies are also subject to stamp taxes. Please see question 6 for a discussion of the applicable rates.

### Transfer of real property

In real property transfers, the taxable capital gain is the difference between the amount or value of the transfer and the sum of the 'basic cost' of the property plus the value of any improvements and any disbursements or expenses required to complete the transaction. In a transfer of real property, the 'basic cost' is the lower of the official property value or its book value.

When the transfer is within the ordinary course of business of the taxpayer, revenue will be treated as regular income and must be reported within the annual income tax return for the corresponding tax period. From 1 January 2012, first-time transfers of residential properties by professional transferors will be subject to a capital gains income tax rate ranging from 0.5 per cent to 2.5 per cent, depending on the value of the property. First-time transfers of commercial or business properties by professional transferors will be subject to a 4.5 per cent tax rate.

If a transfer of real estate is not within the ordinary course of business of the taxpayer, the applicable capital gain income tax rate is fixed at 10 per cent. In such cases, the taxpayer must make an advance payment corresponding to 3 per cent of the higher value between the sale price stated in the purchase or sale document or agreement, or the official property value. Such amount is payable, together with the corresponding property transfer tax, prior to and as a requirement for the filing of the transfer deed at the Public Registry. Further, the seller has the option to:

- consider the 3 per cent as the definitive income tax of the transaction, and take no further action; or
- request a tax credit over any amount paid in excess of the 10 per cent rate of the gains arising from the transaction.

Under this second option, the taxpayer may elect to use the credit to settle other taxes or request a tax refund in cash. Tax credits thus obtained may be assigned to other taxpayers.

Under approved and ratified DTTs, a foreign transferor of real estate located in Panamanian territory may be taxed for capital gains in Panama. DTTs generally refer to the definition of real estate under the applicable laws of the jurisdiction where the property is located. However, DTTs generally provide that real estate includes property affixed permanently to the land, livestock and equipment used in agriculture and forestry.

Transfers of Panamanian real estate are also subject to a 2 per cent transfer tax. Please see question 6 for a discussion of the real estate transfer tax.

### Transfer of chattels

The taxable capital gain for the transfer of chattels is 10 per cent over the difference between the amount or value of the transfer and the original cost of acquisition, plus depreciation. The original cost of acquisition includes:

- the initial invoice value for the asset;
- any expenses relating to its acquisition, installation, assembly and delivery, including sales commissions, insurance and the cost of shipping and handling;
- import taxes; and
- any other expenses or disbursements related to the original acquisition of the asset.

Chattels that are categorised as fixed assets and that are permanently connected to an income-generating business activity may be depreciated on an annual basis. Depreciation is calculated based on the economic lifespan of each asset, which is contingent on the particular use of the asset, maintenance requirements, prospective asset obsolescence and generally accepted depreciation tables. For depreciation purposes, the lifespan of the asset may not be less than three years.

If the transfer of chattels is within the ordinary course of business for the taxpayer, income must be included and taxes paid within the annual income return for the corresponding tax period.

Transfers of chattels belonging to a permanent establishment in Panama may be levied with local capital gains tax under approved and ratified DTTs. Under DTTs approved by Panama a permanent establishment includes business headquarters, branches, offices, factories and workshops, as well as mines, oil or gas wells, quarries or any other site for extraction of natural resources. Building sites and construction or installation projects with a minimum duration of six months depending on applicable treaty provisions are also generally considered as permanent establishments under DTTs approved by Panama.

Transfers of chattels and personal property are also subject to value added tax, domestically known as ITBMS. See question 6 for a discussion of this.

## 2 Step-up in basis

### In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

In acquisitions of stock, the capital gains basis is the book value of the stock as reflected in the most recent audited financial statements of the target company. There is no room for a step-up in basis in the acquisition of stock.

For personal property, the capital gains are assessed on the basis of the cost of acquisition of the property, therefore there is no step-up in basis available.

The transfer of real property, however, does leave room for a step-up. In the sale of real property, the capital gains basis is the 'basic cost' of the property. The 'basic cost' is defined as the lower of the official value of the property and its book value. When the official value of the property is lower than the book value, there is no step-up in basis because capital gains are assessed at such official value. However, tax legislation provides the option of submitting voluntary appraisals of real estate to increase their official value. Under the tax reform adopted through Law No. 8 of 15 March 2010, voluntary appraisals may be submitted to reflect an increase in the official property value. Owners may consider the new official value as the 'basic cost' of the property if one year has elapsed from the date when the voluntary appraisal is approved by the tax authority. Such updated 'basic cost' may be considered by the property owner in order to calculate the applicable capital gains on transfers made after the new value is approved and recorded by the tax authority.

The tax authority is also performing ex officio appraisals. Property values determined by an ex officio appraisal will apply immediately to the property. However, if the taxpayer had previously submitted a voluntary appraisal the value of the ex officio appraisal will become effective five years after the submission of the voluntary appraisal.

Transferors of goodwill and other intangibles at a fixed price payable in a single instalment may deduct as expenses any disbursements paid in connection with acquiring the respective assets, or any filings, registrations or similar operations related to such acquisition. If the acquisition price of goodwill or intangibles is payable in separate instalments, the transferor may prorate the expense amounts so that proportional costs are deducted for each instalment received during the fiscal year. In such case, the following rules will apply:

- if the value of each instalment that comprises the purchase price can be ascertained, deductible expenses for the fiscal period will be determined by apportioning the total acquisition value to the total cost; or
- if the value per instalment cannot be determined, the law assigns a 10 per cent cost to each instalment received within a fiscal year until the transferor fully recovers the capital investment.

Panamanian tax law allows for depreciation of fixed or tangible assets. Intangibles cannot be depreciated for tax purposes.

In a sale or merger of businesses at a fixed total price, the seller or transferor may determine the remaining economic lifespan of each fixed asset included in the transfer, and establish the annual depreciation that will apply based on the market value of each asset. In this case, the total value of the transaction will be distributed among the fixed assets for depreciation purposes based on the valuation methods applicable to each asset.

### 3 Domicile of acquisition company

#### Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

The Panamanian tax system is based on the principle of territoriality. Consequently, taxes are levied on operations within the territorial boundaries of Panama conducted by any person or corporation regardless of their citizenship, residence or domicile. This principle applies even when agreements are negotiated, signed and completed and payments are made abroad.

Under the general territorial taxation principle prevalent in Panama, and the foregoing capital gains and dividend tax considerations, there is no tax benefit if the acquisition is executed by a company established abroad.

Moreover, treatment of capital gains and dividend withholdings does not favour the use of local over foreign companies because:

- capital gains taxes are applicable to income deriving from the sale of chattels and real estate located in Panama, or from stock, securities or the transfer of any economic investment within Panamanian territory, irrespective of whether the transfer takes place within or outside Panama; and
- dividend tax withholding is not applicable to shareholders of Panamanian or foreign companies that serve as holdings of Panamanian companies that are licensed to do business in Panama by the Ministry of Commerce and Industry and are generating local source income. Pursuant to Panamanian tax law, Panamanian and foreign companies are exempted from withholding dividend taxes over any income deriving from a dividend payment, provided that the underlying company declaring such dividends has already withheld and paid the 5 or 10 per cent applicable dividend tax.

However, in the case of a transfer of assets and liabilities that may include a change in ownership of real property or chattels that require registration, a foreign transferee company will need to be registered with the Panamanian Public Registry. A slightly less cumbersome approach would be to work through a local subsidiary.

### 4 Company mergers and share exchanges

#### Are company mergers or share exchanges common forms of acquisition?

Company mergers are common forms of acquisition in Panama, and the merger process is expedient and straightforward. Panamanian laws afford a preferential tax treatment to mergers that meet certain criteria. Accordingly, mergers are often considered for structuring local acquisitions.

Moreover, the flexibility of Panamanian corporate legislation and its merger process, plus a favourable tax treatment, make Panamanian corporations attractive as holding and acquiring entities, and it is commonplace to structure merger transactions that may not necessarily be connected to a local asset or operation.

Under applicable legislation, a merger can be structured between two or more Panamanian companies or with foreign entities as long as, prior to the merger, such foreign entity is registered in Panama or the foreign entity migrates to Panama through the process described in question 12.

Mergers enjoy the following tax privileges:

- exemption from capital gains income tax for companies registered with the SMV. Shareholders of companies that are extinguished as a consequence of a merger are exempt from income tax over capital gains, as long as:
  - share transfers are made through an organised securities market or stock exchange; or
  - shareholders only receive shares of the surviving entity as consideration. Additional cash or valuables that a shareholder receives from the merger to avoid fractioning shares will also be exempt, as long as they do not exceed 1 per cent of the total value of the shares of the surviving company; and
- exemption from income tax, property transfer tax, dividend withholding tax and Panamanian sales tax ITBMS. Merged companies will be exonerated from the foregoing taxes provided that:
  - accounts receivable and reserves are transferred to the surviving entity at book value;

- accounts receivable between the merging companies are set off;
- inventory accounts and reserves for losses from obsolete inventory are transferred separately and at book value;
- assets that can be depreciated and any accumulated depreciation values are transferred separately and at book value (the surviving entity must maintain the same depreciation method and period);
- paid-up capital, reserve capital and surplus and deficit accounts must be integrated within the surviving entity to reflect the net value of each;
- income, costs and expenses of the merged companies are integrated on the income tax return of the period when the merger was completed;
- real property transfers are registered at book value. However, the base value of such property for property transfer and capital gains tax purposes will not be affected by the merger; and
- the tax authority is notified in writing within 30 calendar days from the date when the merger is filed at the Panamanian Public Registry. Such written notice must be submitted together with copies of the documents pertaining to the merger, and an affidavit signed by a Panamanian CPA certifying compliance with the applicable tax and accounting procedures.

Mergers should be preferred over share exchanges because acquisitions through share exchanges are not expressly exempted from capital gains or other applicable taxes. In the case of share exchanges, the transfer of stock by the acquirer to the seller as consideration for the sale of shares in the target company may be taxable over any gains that may be realised if the value of the shares of the acquirer is higher than the value of the shares of the target company.

While transfers involving direct share exchanges are not always favoured, acquisitions through three-cornered mergers or amalgamations where the transferor receives shares of the acquiring group are commonplace. In such cases, the acquirer may elect to merge with the target company, either directly if it is a Panamanian company or through a subsidiary if it is not, thus benefiting from the special tax regime for mergers. As Panamanian company law does not restrict the form of payment between shareholders as a consequence of mergers, the parties may elect to issue shares in the acquiring company to the seller as consideration.

### 5 Tax benefits in issuing stock

#### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

Capital gains tax provisions do not afford any preferences or benefits to straight cash or share exchanges.

However, in the case of a merger of companies registered with the SMV, applicable securities legislation does favour share exchanges over cash payments. As discussed in question 4, shareholders of merging companies that are registered with the SMV are exempt from income tax over capital gains if shareholders only receive shares of the surviving entity as consideration. Additional cash or valuables that a shareholder receives from the merger to avoid fractioning shares will also be exempt, as long as it does not exceed 1 per cent of the total value of the shares of the surviving company.

### 6 Transaction taxes

#### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

In addition to capital gains, the following taxes are relevant to the acquisition or transfer of stock or business assets.

#### Transfer taxes

##### Acquisition or transfer of chattels

ITBMS is charged on transfers of chattels or personal property by sale or otherwise. It is also applicable to all imports. The taxable value is the price paid plus ancillary charges, or in the case of imports, the customs value plus customs charges. All transactions involving the transfer or transmission of tangible personal property, goods or the supply of any



services or personal or real property rentals are subject to ITBMS at a rate of 7 per cent of the value of the sale, service or rental fee. ITBMS applies at a rate of 10 per cent in sales of alcoholic beverages, hotel and other public accommodation services. Sales of cigarettes, cigars and other tobacco products are levied with ITBMS at a rate of 15 per cent.

ITBMS is not applicable to transfers of intangible rights under an acquisition of assets and liabilities or to the transfer of securities.

Sellers of goods, rentals and services, including state-owned industrial and commercial enterprises, and all individuals and corporations are responsible for the collection of ITBMS. ITBMS must be reported and paid to the tax authority within the first 15 calendar days of each month.

Taxpayers with an average monthly gross income not exceeding US\$3,000, and an annual gross income of less than US\$36,000 are exempt from ITBMS.

#### **Acquisition or transfer of real estate**

A 2 per cent real estate transfer tax is levied on the transfer of real estate, including donations and non-lucrative transfers. This 2 per cent tax is charged to the sale price stated in the official purchase or sale agreement or contract, or the official property value (whichever is higher).

The 2 per cent transfer tax is payable to the tax authority prior to registration of the transfer deed at the Public Registry, together with the applicable capital gains tax. The corresponding tax receipts issued by the tax authority must be incorporated into the property deed before the deed is filed with the Property Registry.

#### **Stamp taxes**

A stamp tax at the rate of US\$0.10 for each US\$100 of the face value of the corresponding obligations may be levied over certain documents or transactions. Any business transaction that involves documents not subject to filing fees or that are not levied with other transfer taxes, such as ITBMS, is subject to stamp tax.

Stamp tax may be paid either by an imprinted stamp on the transaction document with a value reflecting the tax amount or by filing a stamp tax return with the tax authority. Taxpayers whose line of business requires them to deal with recurrent stamp tax payments must submit a monthly stamp tax return. Agreements that are subject to stamp tax must bear either the stamp mark or the stamp tax return, evidencing payment. Thus, it is customary for stamp tax to be paid when the agreement is executed or immediately thereafter, to ensure compliance.

Documents relating to matters that are not connected to taxable income in Panama are exempted from stamp tax unless they have to be submitted to a court or administrative authority in Panama.

#### **7 Net operating losses, other tax attributes and insolvency proceedings**

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Operating losses are non-transferable from a target company to an acquiring or resulting entity, even when the acquisition is through a merger or consolidation. However, this principle does not extend to a change in control of a target company in the case of stock acquisitions. Net operating losses and tax attributes of the target are not limited or affected by a change of control of the target through the acquisition of its stock or by its insolvency. Therefore, the target company will retain the right to carry forward losses or benefit from tax attributes pursuant to the applicable tax provisions.

Under Panamanian tax law, losses suffered by a taxpayer during the fiscal year may be carried forward for the next five years. During such period, the taxpayer may deduct up to 20 per cent of the total loss carried forward each year. However, tax deductions relating to carried-forward losses may not exceed 50 per cent of annual net income. Any portion of the 20 per cent loss allowance that is carried forward and that is not deducted during the corresponding year may not be deducted in other fiscal periods and will not give rise to any tax credit in favour of the corresponding taxpayer.

Further to the above, accounts receivable that are time-barred from collection or that cannot be recovered due to the insolvency of the debtor may be deducted from a taxpayer's annual profits and losses as long as the respective accounts are connected to a taxable source of income for said taxpayer and are duly reflected as gross income in the taxpayer's books and records. From 1 January 2014, the corporate income tax rate is fixed at 25 per cent.

The corporate income tax rate is assessed over the income generated by taxable activities in Panama less cost and expenses incurred exclusively in the production of such income or the conservation of its source and deductible allowances.

Companies with an annual taxable income of more than US\$1.5 million are subject to an alternate minimum tax (AMT). The AMT criteria require companies that exceed the foregoing income threshold to pay the higher of:

- net taxable income calculated by the traditional method or the standard income tax formula that discounts deductible expenses and deductible allowances from gross income; or
- net taxable income resulting from applying 4.67 per cent to the total taxable income.

Income tax returns are due 90 days after the close of the fiscal year. However, the tax regulations provide for a single 30-day extension to file the income tax return.

Along with the income tax return, companies must submit an income estimate for the following tax period. The income estimate must be equal to or higher than the taxable income for the last reported period. Estimated income tax is paid in three instalments that are due on 30 June, 30 September and 31 December. Adjustments between the tax assessment for the last reported period and the income estimate are made in the annual income tax return of the extant period.

A company that yields net operating losses after being forced to file its income tax return due to the AMT rules may request the non-applicability of the AMT. If the request is approved, the company will be allowed to calculate and file its income tax return in accordance with standard income tax rules.

#### **8 Interest relief**

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Pursuant to Panamanian tax legislation, all expenses connected with the generation or preservation of taxable or local source income within a fiscal period may be deducted from that period's income for income tax purposes.

Interest payments made to local or foreign creditors may be deducted for income tax purposes, as long as the financing arrangement under which interest is disbursed relates to the production or conservation of local source income.

There is no interest relief for borrowings to acquire the target. However, interest payments over borrowings are deductible expenses for the buyer of the acquired assets or stocks.

The foregoing principles apply, without distinction, to local, foreign or related lenders. There are no restrictions on deductibility if the lender is local, foreign or related. However, interest, commission, other charges over foreign loans and any other type of financing arrangement are subject to withholding at a rate calculated by applying the respective standard income tax rate set forth in question 7 over 50 per cent of the corresponding payment to the foreign creditor.

The standard income tax rate is 25 per cent, so the withholding tax will be assessed at an effective tax rate of 12.5 per cent of the total payment to the foreign creditor. Such interest withholding must be made by the local borrowing entity regardless of the type of financing arrangement in place with the foreign lender. The foreign lender is not liable to any further income or any other tax payment or tax return with respect to said interest payments. In some cases, it is possible to structure the foreign loan in a manner that will mitigate the interest withholding tax.



Interest payments by a Panamanian borrower to a creditor with residence in a jurisdiction that has an approved and ratified DTT with Panama may be subject to a maximum withholding ranging from 5 to 15 per cent over the gross interest amount. The withholding will depend on applicable treaty provisions classifying the type of creditor and interest payment.

Financing arrangements with Panamanian-based lenders are not subject to interest withholding. Payments to local lenders are the responsibility of those local lenders, and must be treated as local source income in accordance with regular and applicable income tax principles and regulations.

There are no restrictions on debt pushdown under Panamanian tax law. Debt pushdown is usually achieved through mergers or the assignment of debt from parent to subsidiary companies, though depending on the type of lender, other restructuring and pushdown methods may also be available.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Protection in the case of stock and business asset acquisitions is commonly sought through the insertion of appropriate warranties, covenants and indemnities in the respective sales agreements or acquisition documents. Similarly, it is also customary to conduct tax, accounting and financial due diligence of target companies.

Sellers ordinarily indemnify acquiring parties from tax obligations arising in connection with the target's activities. Such indemnities may include income tax liabilities and liability for ITBMS, property and other taxes relating to the target's assets or operations.

When crafting acquisition or merger agreements, acquiring and merging parties should take into account various statutes of limitations. Chief among those is the statute of limitations for income tax, which is seven years. The tax authority has seven years to collect income tax, calculated from the last day of the fiscal year when such income tax was payable. However, the statute of limitations is reduced to three years if collection is sought after a tax audit has detected improper tax returns or missing payments. Taxpayers have three years to request credits or reimbursement for payment of undue taxes from the date when such undue payment was made.

For payments relating to withheld tax amounts, the statute of limitations is 15 years. As described in question 1, buyers acquiring stock and securities are required to withhold the respective capital gains tax and pay the same within 10 calendar days from the date when payment to the seller was made. Although the target company becomes jointly liable for due payment of capital gains taxes, sellers may also require further assurances and confirmation of remittance to prevent liability.

It is generally recommended that acquisitions include the use of trusts or escrow agreements. This allows completion of any impending requirements for closing and also for a thorough due diligence of real property and other assets in transactions where time is of the essence.

Indemnity or warranty payments connected to a source of taxable income in Panama are also subject to income tax. Such payments must be considered as part of the taxpayers' gross taxable income for the fiscal year when they are received and eventually taxed at the applicable tax rates set forth in question 7.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

Post-acquisition restructuring in Panama is usually undertaken to simplify the corporate structure of the target entity in order to reduce tax, labour and potential operational liabilities that may arise in connection with the resulting group entities.

The capital gain income tax outlined in question 1 is applicable to transfers of securities when the seller transfers the shares of the target company directly or when the seller transfers the shares of the

target company by transferring the shares of another holding company. Therefore, maintaining cumbersome indirect holding structures does not necessarily provide tax benefits for the acquiring party's operations, or for future transfers of the target or its assets.

Therefore, corporate consolidation is the most relevant restructuring that usually takes place post-acquisition. It is common for intermediate subsidiaries used exclusively for holding purposes to merge with affiliates or subsidiaries to promote efficient control of the acquired entity and to correct tax inefficiencies.

In addition to changes in the corporate structure, post-acquisition tasks usually include a review of staff, management, executive and director removals and appointments, as well as all related labour issues. When the acquiring party is an economic group involved in the same business as the target this is a very important aspect, as appropriate restructuring will reduce the labour, social security and tax liabilities arising from redundant or duplicate posts and offices.

If the acquiring company or group is from overseas, immigration and labour permit-planning is also pivotal.

It is also common to review the situation with target group loans and other financing structures to reduce financing costs, release mortgaged or encumbered assets and procure favourable tax arrangements. Such restructuring may address, for example, any possible withholding taxes on interest payments abroad, as described in question 8.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Recently adopted legislation regulates corporate spin-offs. Under the new legislation, a spin-off can be structured by divesting the assets and liabilities owned by a Panamanian corporation in exchange for the equity of one or more Panamanian companies. Operating losses may not be transferred through a spin-off.

The transferee may also be a foreign company if the foreign company was previously registered in Panama, or if the foreign company migrates to Panama through the process described in question 12.

The transfer of assets and liabilities through a corporate spin-off will not be subject to taxes, provided the assets and liabilities are transferred at the book value. However, parties to the spin-off are required to provide prior written notification to the tax authority of the corporate spin-off.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

It is possible for Panamanian companies to migrate to or continue their existence in other jurisdictions. There are no specific taxes in Panama relating exclusively to the migration of a company. To migrate into another jurisdiction, a Panamanian company must approve and file the respective corporate authorisations with the Panamanian Public Registry. The company must then comply with the continuation requirements of the foreign jurisdiction and obtain its local deregistration.

Although the migration process itself is straightforward, steps must be taken locally to ensure that any assets or operations that require local registration are dealt with in due course. Hence, if the migrating Panamanian company holds any real property, such real property will need to be transferred to a Panamanian entity or to a foreign company registered in Panama.

If the migrating company continues to do business in Panama as a foreign corporation, it is important to ensure that the business activities the migrating company is licensed for may continue to be carried out by a foreign entity.

If the migrating company ceases its operations in Panama, it will need to wind up its local business and cancel its taxpayer registration. Within 30 days from the date when the company ended all business operations, the company must file a final balance and income tax return, notify the tax authority and pay income tax for any remaining or leftover income. The company must pay the corresponding income tax

due at closing. If the company is subject to payment of ITBMS, a final ITBMS return must be filed to complete payment of collected taxes for the period immediately prior to termination of business operations.

Finally, the company must complete payment of any outstanding municipal taxes for which it may be liable and inform the municipal authorities regarding the termination of its business operations.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interest, commission, other charges over foreign loans and any other type of financing arrangement associated with the production or conservation of local sources of income are subject to income tax withholding by the local borrower.

The borrowing entity is required to apply a withholding over 50 per cent of the payment to the foreign lender at the standard income tax rate set forth in question 7. Hence, a 12.5 per cent effective withholding tax rate is currently applicable over interest payments from foreign financing arrangements. Such interest withholding must be made by the local borrowing entity, regardless of the type of financing arrangement in place with the foreign lender. The foreign lender is not liable to any further income or any other tax payment or tax return with respect to said interest payments. If the foreign lender is an income tax payer, this interest withholding is not required. In some cases, it is possible to structure the foreign loan in a manner that will mitigate the interest withholding tax.

Financing arrangements with Panamanian-based lenders are not subject to interest withholding. Payments to local lenders are the responsibility of those local lenders, and must be treated as local source income in accordance with regular and applicable income tax principles and regulations.

As mentioned in question 8, interest payments by a Panamanian borrower to a creditor with residence in a DTT jurisdiction are subject to a maximum withholding ranging from 5 to 15 per cent over the gross interest amount. The withholding rates are contingent on applicable DTT provisions that may classify the type of creditor and interest payment.

A dividend tax is levied on the distribution of dividends to shareholders of Panamanian companies that are licensed for business by the Panamanian Ministry of Commerce and Industry or generate taxable income in Panama. If the company has issued:

- registered shares, the applicable dividend withholding is 10 per cent over dividends distributed from local source income, and 5 per cent over dividends distributed from foreign source income, income from free-zone operations or exports. Distribution of local source dividends must be completed before foreign source dividends may be distributed; and
- bearer shares, the applicable dividend withholding is 20 per cent.

The company paying dividends is responsible for withholding the tax from distributions to the shareholders and remitting the withheld dividend payment to the tax authority. In the event that there are no dividend distributions for a specific fiscal year, or if the company distributes less than 40 per cent of its net earnings for the fiscal year, the company must remit to the tax authority an advance payment of 10 per cent of the difference between the amount distributed and the total net earnings. Panamanian tax law calls the advance dividend payment a complementary tax. In the case of companies that operate from a free zone, an advance payment or complementary tax of 10 per cent is applicable over the difference between the amount distributed and the total net earnings, if less than 20 per cent of the net earnings are distributed. Dividend taxes must be paid to the tax authority within 10 days from the respective withholding, whereas complementary taxes are payable during the three months following the legal term to submit the applicable income tax returns for the respective period.

Dividend tax withholding is not applicable to shareholders of Panamanian companies that do not require a licence from the Ministry of Commerce and Industry, operate within Panama under special investment statutes, or serve as holdings of other Panamanian or foreign companies that do not generate taxable income in Panama.

Panamanian companies are exempted from withholding dividend taxes over any income deriving from a dividend payment, provided that the company declaring such dividends has already withheld and paid the 5 or 10 per cent applicable dividend withholding.

DTTs approved by Panama generally provide that dividend tax is withheld at rates ranging from 5 to 15 per cent over the gross amount of the dividends. The withholding will depend on applicable treaty provisions.

Panamanian tax law confers pre-eminence over local law to dividend tax provisions adopted by DTTs. In the absence of a tax treaty, the applicable dividend withholding is 10 per cent over dividends distributed from local source income, and 5 per cent over dividends distributed from foreign source income, income from free-zone operations or exports.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Profits can be extracted from a Panamanian operating company through dividends, interest payments or payments to a foreign parent or affiliate in connection with services rendered abroad.

Dividend distributions and interest payments to foreign creditors are subject to withholding taxes. As outlined in question 13, a dividend withholding of 10 per cent is applicable to most companies. A 5 per cent dividend withholding is applicable to companies that operate from a free zone and to foreign source income.

Interest and other payments to foreign creditors are subject to a withholding rate that is calculated by applying the respective income tax rates set forth in question 7 over 50 per cent of the corresponding interest payment. The applicable tax rate over the total payment to a foreign creditor is currently 12.5 per cent.

Payments to foreign entities in connection with services rendered abroad are considered local source income and are thus taxable under Panamanian law, provided that such services relate directly or indirectly to the generation or preservation of local source income, and that the local company benefiting from the services declares payments made to the foreign entity as a deductible expense for income tax purposes. The local company receiving the services must withhold at the corporate income tax rate over 50 per cent of the payment amount to the foreign service provider, or an effective withholding rate (currently 12.5 per cent) only if it elects to declare payments to the foreign entity as deductible expenses. In these cases, the foreign entity is not liable for any further income tax for these payments.

Transactions between Panamanian taxpayers and related parties that are tax residents in foreign jurisdictions are subject to transfer pricing regulations when the following conditions are met:

- a Panamanian taxpayer conducts an income-producing operation with a related party; and
- such operation has an impact in the assessment of income tax in Panama with respect to taxable income, costs, deductible expenses or determination of the applicable tax basis.

Panamanian transfer pricing regulations provide that two or more persons are considered related parties when:

- one of such parties participates directly or indirectly in the management, control or capital of the other party;
- a group of persons participate directly or indirectly in the management, control or capital of such parties; or
- the headquarters or permanent establishments are abroad of an entity with a permanent establishment in Panama.

Any related party operations will be subject to a comparability analysis through the application of approved valuation methods to review arm's-length standards.

Panamanian taxpayers are required to keep sufficient information and supporting documents in connection with any foreign-related party transaction, and to file annual reports regarding the operations with any foreign-related party. Transfer pricing annual reports must be filed within six months of the close of a taxpayer's fiscal period.

**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Disposals are most commonly carried out through a disposal of stock in the local company or the local or foreign holding company. In both cases, the applicable capital gains treatment will be the same, inasmuch as both transactions involve a transfer of an underlying economic interest in Panama (see question 1).

Since asset deals will also involve transfer taxes over personal and real property, these transactions may become more complex and time consuming. However, they are often preferred by sellers seeking to mitigate potential liabilities such as prospective civil or labour litigation, incomplete or unclear corporate records and risky assets.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Disposal of stock from a Panamanian operating company is subject to capital gains taxes regardless of whether the selling, buying and target entities are foreign companies operating abroad.

As discussed in question 1, applicable tax legislation makes capital gains applicable to the transfer of any economic investment within Panamanian territory, irrespective of whether the transfer takes place within or outside Panama. Accordingly, capital gains taxes are applicable to the disposal of stock on any foreign company directly or indirectly owning stock in a company that operates in Panama and generates local source income. Foreign transferors may benefit from the tax treatment afforded to capital gains in disposals of stock under DTTs approved and ratified by Panama. As such, a foreign transferor may elect to pay capital gains in Panama subject to applicable treaty provisions and avoid a double taxation in its country of residence. For additional discussion of treatment, see question 1.

To prevent indirect transfers of stock through foreign holding companies, Panamanian tax legislation makes the local operating entity jointly responsible for any unpaid capital gains taxes.

There are no special rules dealing with the disposal of stock in real estate companies. However, prospective buyers of energy companies must ensure compliance with antitrust regulations, vertical integration restrictions and capital composition requirements. Buyers must also ensure they gain the approval of the Antitrust and Consumer Protection Authority and the corresponding energy sector regulator, the National Authority of Public Services, or the Energy Secretariat to continue the operation of the applicable concession or licence.

Natural resource company buyers must meet antitrust and capital composition requirements and must gain the approval of the Ministry of Commerce and Industry, the Secretary of Energy and the Antitrust and Consumer Protection Authority to continue the operation of the applicable concession or licence.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Capital gains and stamp taxes connected to acquisitions of stock are due when payment for the respective transaction is made. An option for deferring a portion of the applicable taxes in stock acquisitions is available in transactions that require payments in instalments or over a period of time. If structured appropriately, acquisition of chattels may also provide the same opportunity for deferring the payment of capital gains tax and ITBMS. Property capital gains and transfer taxes are due prior to registration of the property transfer, so there is little chance for deferral in real estate transactions.

However, capital gains provisions in connection with the transfer of stock, chattels and real property provide the option of requesting tax credits when withholding values that are higher than the applicable capital gains at the rate of 10 per cent (see question 1). If the withholding is higher, the seller may request a tax credit for the difference. The seller has up to three years to offset the credit against other taxes or to request a cash return. Although the tax credit does not help the seller in reducing or deferring capital gains, it does allow the seller room for limited tax planning.



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# Portugal

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## Acquisitions (from the buyer's perspective)

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### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The acquisition of stock in a company in principle has no tax impact on the buyer. The only exception is in the acquisition of 75 per cent or more shareholdings in limited liability companies with the capital divided in quotas and general or limited partnerships that own real estate. In this case it is considered that the transaction is assimilated to a direct acquisition of the real estate that is subject to real estate transfer tax. The tax rate of real estate transfer tax is: 6.5 per cent rate for urban property, 5 per cent for rural land and 10 per cent if the acquirer is a company resident in a blacklisted jurisdiction. This tax is not due in the acquisition of stock in limited liability companies with the capital divided in shares. It is possible to convert a limited liability company with the capital divided in quotas into a limited liability company with the capital divided in shares before the acquisition of 75 per cent or more shareholdings to avoid this tax in case the company has immovable property. Portuguese tax law has a General Anti-Avoidance Rule (GAAR). As far as we are aware, the Portuguese tax authorities have never applied the GAAR in this situation (conversion of a limited liability company with the capital divided in quotas into a limited liability company with the capital divided before the acquisition of the shareholding).

The acquisition of business assets and liabilities may be made through an acquisition of distinct assets and liabilities or through a transfer of business as a going concern if the assets and liabilities acquired qualify as an enterprise or a business (ie, if the assets and liabilities have enough autonomy to generate profit on their own).

The acquisition of distinct assets and liabilities is generally subject to VAT. The current standard VAT rate is 23 per cent.

The acquisition of a business through a transfer of business as a going concern is not subject to VAT, but may be subject to stamp duty at the rate of 5 per cent. There is a certain degree of uncertainty in the tax treatment of this deal. We know that there is an internal opinion from the tax authorities defending that a transfer of business as a going concern is only subject to stamp duty if, together with the business, a lease of immovable property is also transferred to the buyer. Accordingly, some authors and practitioners maintain that if there is no lease agreement of immovable property associated with the acquisition of the business, no stamp duty shall be paid. There is also some degree of uncertainty in relation to the tax base of the stamp duty. While some maintain that the tax base is the goodwill acquired as shown in the accounts of the buyer, others consider that the tax base is the price paid.

In case one of the assets is immovable property, in principle no VAT is due as the acquisition of immovable property may be VAT exempted, but real estate transfer tax at the above-mentioned rates is due. The tax base for the real estate transfer tax is the higher of either the property tax value as shown in the tax certificate of the property and the agreed price. In the acquisition of immovable property, stamp duty is also due at the rate of 0.8 per cent on the higher of either the property tax value as shown in the tax certificate of the property and the agreed price.

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### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In principle, it is not possible to have a step-up in the business assets of the target company. In exceptional cases the law may allow for revaluations relevant for tax purposes.

Goodwill acquired in a concentration of activities and other intangibles may be depreciated for tax purposes in a 20-year period, provided such goodwill and intangibles are recognised in the company's accounts.

In the event of a purchase of stock in a company, goodwill depreciation is not allowed for tax purposes.

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### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

Provided the acquisition company is not located in a blacklisted tax jurisdiction (in which case it is not recommended because it is generally not tax efficient), it should not matter whether the holding company is in Portugal or abroad as Portugal has a competitive participation exemption regime for dividends and capital gains.

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### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Company mergers and share exchanges are both common operations and are used either to acquire target companies or to perform intra-group reorganisations (the latter operations are most common).

The Portuguese Corporate Income Tax Code foresees a tax neutrality regime (deriving from the transposition of the EU Tax Merger Directive to domestic law) for both operations. The special tax neutrality regime may be applied to these operations provided that they are executed between companies resident in Portugal and companies resident in another EU member state.

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### 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

There is no tax benefit to the acquirer in issuing stock as consideration rather than cash.

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### 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

Please see question 1.



## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

The right to carry-forward the tax losses is lost in cases where there is a change of control of the target. Notwithstanding, the Ministry of Finance may authorise the preservation of existing tax losses if the taxpayer presents a writ to the tax authorities and demonstrates the economic interest of the operation. Such writ has to be presented within 30 days after the change of control has occurred.

The tax-neutral regime applicable to corporate reorganisations allows for the maintenance of: the net operating losses generated in previous tax years, tax benefits and net financial costs thresholds yet to be deducted to be transferred to the acquiring company, provided certain conditions are met.

In relation to bankrupt or insolvent companies there are the following tax benefits:

- exemption of corporate income tax on the capital gains made by the insolvent in some circumstances;
- exemption of corporate income tax on increases in equity due to debt forgiveness;
- exemption of stamp duty on the extension of the maturity of loans;
- exemption of stamp duty on financial operations and on transfer of businesses as a going concern;
- exemption of stamp duty on the issuance of letters of credit; and
- exemption of real estate transfer tax on the acquisition of immovable property in certain circumstances.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interest may be deductible provided that said interest refers to a loan incurred for obtaining income subject to corporate income tax. Nevertheless, the deduction of annual interest expenses is limited to the highest of the following amounts: €1 million or 30 per cent of the company's earnings before interest, taxes, depreciation and amortisation.

The amount of financial expenses not deductible as a consequence of exceeding the aforementioned limits may be carried forward and deducted in the following five years (but always taking into consideration the applicable limits in each year).

In case the buyer is a related party, the interest paid has to be at arm's length.

As a rule, the payment of interest is subject to withholding tax at the rate of 25 per cent, which may be reduced by the application of a double tax treaty. There is an exemption of withholding tax on the payment of interest to banks resident in Portugal. As this exemption does not apply to non-resident banks it has recently been judged against European Union Law by the Court of Justice of the European Union. A change in the law is expected in the medium term. There is an exemption for interest paid by resident banks to non-resident banks. An exemption of withholding tax on the payment of interest may also be requested from the Ministry of Finance in the case of foreign loans obtained by companies that provide public services.

Debt pushdown may be achieved, for instance, by reverse mergers or by sale of credits. This matter has been subject to controversy between the tax authorities and taxpayers, therefore consulting a tax adviser is recommended before implementing such structure.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Warranties, indemnity clauses and deed of tax covenants are common mainly for stock and business assets acquisitions made by foreign buyers. In purely domestic transactions it is less common to use these types of clauses. Accordingly, it is more common to see these types of clauses in share and purchase agreements subject to foreign law. Only the indemnities related to those events whose risk may not be insured are deductible for tax purposes. From the perspective of the recipient, the indemnity is considered an income relevant for the determination of the taxable profit subject to corporate income tax.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

It is not common to see a standard or typical post-acquisition restructuring. In some circumstances there may be mergers mainly to avoid having two corporate entities or exchange of shares to obtain a simpler corporate structure or to facilitate the flow of dividends.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

The special tax-neutral regime regarding corporate reorganisations that, among others, allows the preservation of tax losses in some circumstances may also be applicable to spin-offs, provided the following specific requirements are met:

- the companies to be subject to a spin-off are resident in Portugal and are subject to and not exempt from corporate income tax therein, or are resident in another EU member state;
- the spin-off is performed for valid economic reasons and is not executed with a main or sole tax related purpose; and
- the depreciation and amortisation methods, as well as the inventory adjustments, impairment losses and provision regime previously used by the acquired company should be maintained for tax purposes.

A spin-off may also be executed without triggering transfer taxes (namely property transfer tax and stamp duty, when there is immovable property to be transmitted). To benefit from these exemptions, the company has to submit a special request to the Minister of Finance, stating the economic advantages of the operation unless the branch of activity that was subject to spin-off is destined to be incorporated in a pre-existing company. In this last scenario it is not necessary to apply for prior approval.

### 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

The Portuguese exit taxes have been subject to discussion through the years and some cases even reached the Court of Justice of the European Union, although mainly on a personal income tax perspective.

Currently, the change of residence of a company resident in Portugal triggers a corporate income tax liability. The taxable income is assessed on the year in which the company changes its residence to a location outside Portugal.

Should the company opt for migration to another EU member state or to a country within the EEA (provided the country has exchange of information obligations with Portugal similar to those established within the EU), the corporate income tax assessed by the positive

### Update and trends

The introduction of a legal framework for the incorporation and activity of real estate transfer trusts (REITs) in Portugal is currently being prepared.

The introduction of this investment vehicle intends to attract more investors to the Portuguese real estate sector, as well as to allow the restructuring of the structures of investment currently held by the players already acting in our market.

This regime should closely follow the main features usually associated to these investment vehicles, in particular the Spanish REITs regime, as regards:

- the minimum amount of share capital and legal type of companies that may benefit from this regime;
- the requirements related with the assets that may be held by the REITs, as well as debt limits; and
- the dividends' distribution rules.

On the other hand, according to the information we have obtained, it is foreseeable that these vehicles will benefit from the tax regime applicable to the Portuguese real estate investment funds. Therefore, it is generally expected that the REITs will in practice be exempted from corporate income tax the income arising from:

- real estate rents;
- gains related to the sale of properties; and
- interest or dividends paid by entities participated by the REIT.

It is still to be confirmed whether the REITs will be subject to tax on the NAV of their assets as it currently happens with REIF, that are subject to quarterly stamp duty at a rate of 0.0125 per cent.

balance of the market value and the tax value of the company's assets may be settled in the following terms:

- immediately, for the whole amount or through instalments;
- in the year following the one in which the company changed residence; or
- in up to five annual partial payments, each corresponding to one-fifth of the tax assessed: these payments starting on the year following the change of residence to a jurisdiction outside of Portugal.

Interest will be due whenever the company chooses one of the deferred payment possibilities (starting on the date from which the immediate payment should have been carried out until the effective payment of the total due amount) and, additionally, the Portuguese tax authorities may request a bank guarantee corresponding to 125 per cent of the tax due.

### 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

In broad terms, interest and dividend payments made by Portuguese resident companies to non-resident companies without a permanent establishment in Portugal to which the income is attributed are subject to final withholding tax at a rate of 25 per cent.

Notwithstanding, the withholding tax rates applicable to interest and dividend payments may be reduced through the application of a double tax treaty.

Therefore, assuming that the entities are able to comply with the requirements to trigger the application of the applicable double tax treaty (usually through the filing and certification of a specific formulary), the beneficiary may benefit from interest and dividend payment rates that usually range between 5 and 15 per cent.

Furthermore, dividends or interest payments, whenever the requirements set by the EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive (respectively) are met, are exempt of withholding tax.

There is also an exemption of withholding tax for dividends paid to entities resident in a country with whom Portugal has in force a double tax treaty provided the beneficiary is subject and not exempt to a tax similar to the Portuguese corporate income tax, the tax rate of such tax is not less than 12.6 per cent, the shareholding in the Portuguese

company is not less than 10 per cent of the share capital or the voting rights of the Portuguese company and was uninterruptedly held in the year prior to distribution. To benefit from this exemption, the beneficiary of the dividends has to present to the Portuguese subsidiary before dividends are distributed a declaration confirmed and certified by its tax authorities stating that it is resident in a country with which Portugal has a double tax treaty, it is subject to and not exempt from a tax similar to the Portuguese corporate income tax and the tax rate of such tax is not less than 12.6 per cent.

Finally, we highlight the anti-abuse rule, which foresees that interest and dividend payments are subject to withholding tax at a 35 per cent rate, if the beneficiary is resident in a blacklisted jurisdiction.

### 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

If there is a shareholder loan outstanding, the reimbursement of the capital borrowed by the Portuguese subsidiary is not subject to tax.

### Disposals (from the seller's perspective)

#### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The three options are commonly pursued depending on the circumstances. From a buyer's perspective the disposal of the business assets may be of advantage if the local company has tax liabilities or litigation pending, although in some situations the tax authorities have a privilege or guarantee over the assets sold.

From the seller's perspective, a sale of stock may be preferable because it may benefit from the participation exemption on capital gains.

#### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

First it is important to determine if there is a double tax treaty in force with the state of residence of the seller because such convention may exclude the competence of Portugal to tax such gain.

The majority of the double tax treaties signed by Portugal provide that the capital gains arising from the disposal of shares should be taxed at the jurisdiction where the transferor is resident. This tax allocation may differ if the disposal is of shares in companies whose assets are mainly composed of real estate located in Portugal.

Otherwise, there is also an exemption foreseen in the law for capital gains made by non-resident entities on the sale of shares, provided the following conditions are met:

- no more than 25 per cent of the non-resident company is owned, directly or indirectly, by Portuguese resident entities, with the exception of the following cases, whenever the requirements below are met, regarding the non-resident company:
  - the beneficiary entity of the capital gain is resident in an EU member state, in a state of the EEA that is bound to administrative cooperation in tax matters in terms equivalent to the administrative cooperation available in the EU, or in a third state with which Portugal has celebrated a double tax treaty that foresees exchange of information agreement in tax matters;
  - the beneficiary entity of the capital gain is subject and not exempt from tax in accordance with article 2 of the Directive 2011/96/EU or another tax similar to corporate income tax, provided the applicable rate is not lower than 12.6 per cent;
  - the beneficiary entity of the capital gain has a direct or indirect 10 per cent shareholding or voting rights for a period of one year on the Portuguese resident entity;
  - the transfer of shares is not considered as part of an artificial arrangement with the main or single purpose of obtaining a fiscal advantage;

- the non-resident does not have as its place of residence a black-listed jurisdiction; and
- the capital gains do not arise from the transfer for consideration of shares or other movable assets in a Portuguese company of which the assets primarily consist (more than 50 per cent) of immovable property located in Portugal or in a Portuguese holding company that controls such a company.

Finally, there are no specific tax rules applicable to energy and natural resources companies.

#### 17 Avoiding and deferring tax

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

A tax rollover regime of up to 50 per cent of the capital gains arising from the disposal of business assets may be used, through the application of the reinvestment regime. In general terms, the sale proceeds shall be used on the acquisition, production or construction of other tangible or intangible assets. The reinvestment operation must comply with the arm's-length principle and the assets shall be subsequently held by the acquirer for at least one year.

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# Switzerland

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

There will be different tax implications for the seller and the acquirer depending on whether an acquisition is carried out by way of acquisition of stock (share deal) or acquisition of business assets and liabilities (asset deal). An acquirer often prefers an asset deal as in this case the tax risks transferred with the acquired business are very limited: tax risks of the acquired business may be inherited in the areas of VAT, customs, social security and real estate taxes. Further, a step-up in basis and tax-deductible depreciation is, in principle, possible (see question 2) and interest for acquisition debt may be set off against taxable income of the acquired business.

Sellers typically prefer share deals in order to benefit from privileged tax treatment of capital gains (for Swiss corporate sellers), respectively tax-exemption in the case of Swiss-resident private individual sellers, except in cases of an indirect partial liquidation (see below). The acquirer of shares in a Swiss company assumes potential historical tax risks and the tax book values of the target company, since both remain unchanged in the target company. The goodwill reflected in the share price generally cannot be written off against taxable profits. The allocation of interest expenses on acquisition debt of the acquirer cannot be directly set off against taxable income of the target, but requires additional structuring. It should be noted that the acquisition of a partnership interest is, from an income tax perspective, generally treated like an asset deal and results in a step-up for the acquirer.

In case of an asset deal, potential tax loss carry-forwards of the business remain with the seller. The asset transfer is generally subject to VAT at 7.7 per cent (effective as of 1 January 2018; previously 8 per cent) on the transfer of taxable goods and goodwill to the extent the assets are purchased by a Switzerland-based company or permanent establishment. The asset transfer between two Swiss entrepreneurs for Swiss VAT purposes may be carried out without VAT payment by way of notification procedure (eg, if an organic unit is transferred). Should real estate be transferred, special cantonal or communal tax rules need to be considered (real estate gains taxation for the seller and real estate transfer taxes).

In case of a share deal, the target company may continue to use a potential tax loss carry-forward and can set it off against a taxable profit during the ordinary tax loss carry-forward period of seven years. The acquisition of shares in a Swiss company is not subject to Swiss VAT, independent of the domicile of a corporate acquirer. Special considerations should be given in case the selling shareholders are Swiss-resident private individuals selling (alone or together) at least 20 per cent in the share capital of a Swiss company: under certain circumstances, this could create an indirect partial liquidation risk for the sellers. That is, re-qualification of tax-free capital gain into taxable investment income, if the target company makes a harmful distribution of previously accumulated profits to the buyer within five years after the transaction, for which the sellers typically include an indemnity clause in the sale and purchase agreements (SPA). Furthermore, in situations where the foreign resident sellers could not avail themselves of a full refund of Swiss withholding taxes on dividends received from the Swiss target

company, buyers residing in Switzerland or in a jurisdiction having a favourable tax treaty with Switzerland may be facing an ongoing, latent full Swiss withholding tax exposure on undistributed profits ('tainted old reserves' of the target company as of the date of the share acquisition).

With regard to transaction taxes, see question 6.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

In cases when the purchase price in an asset deal exceeds the fair market value of the net assets of an acquired business, an acquirer may capitalise such difference as goodwill, which is typically depreciated as per Swiss tax and accounting rules at 40 per cent per annum (declining balance method; the remaining amount depreciated in last year) or at 20 per cent per annum (straight-line method) over five years. The same depreciation generally applies to the part of the purchase price allocated to intellectual property (IP). Such depreciation expense is generally deductible from taxable income.

In the case of a share deal, the purchase price is entirely allocated to the shares acquired and the taxable basis of the target company remains unchanged (ie, no goodwill is recognised). A depreciation on the acquired shares is typically not possible for a Swiss acquirer, unless there is a decrease in the fair market value of the shares. Such adjustment of the share value is tax-deductible for a Swiss corporate acquirer; however, if the value of a participation of at least 10 per cent recovers in subsequent years, Swiss tax authorities may demand the reversal of the adjustment or depreciation up to the original acquisition cost basis, which is taxable.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

In case of an asset deal, a Swiss acquisition company is highly preferable from a tax and legal perspective. Otherwise, the acquired business will likely constitute a permanent establishment of a foreign acquirer, creating the need to prevent international double taxation through the allocation of profits between the acquirer's foreign head office and its Swiss permanent establishment.

Even though Switzerland has no tax-consolidation rules (except for VAT), a Swiss acquisition company may be a good choice for a share deal. If it fulfils the required conditions, the acquisition company may benefit from the holding company taxation (effective tax rate of 7.83 per cent due to a full income tax exemption on a cantonal and communal level, participation deduction for qualifying dividends and capital gains at the federal tax level, see below); however, the cantonal and communal holding company exemption will eventually (with a certain transition period) be abolished, with the contemplated next Swiss tax reform (StAF) to be adopted by Swiss parliament in autumn 2018 and expected to enter partially into force from 1 January 2019, with most of the measures being introduced as of 1 January 2020. Also after implementation



of the StAF, Switzerland will be an attractive location for the acquisition company owing to low overall effective tax rates (eg, around 11.2 per cent in the canton of Lucerne or around 12 per cent in the canton of Schwyz) and new tax reduction measures that may be introduced in the context of the StAF (eg, reductions of cantonal capital tax, tax privileged step-up). Switzerland has no controlled foreign corporation (CFC) regime and is currently also not planning to introduce such rules.

Any dividend income from qualifying participations of at least 10 per cent (or with a fair market value of at least 1 million Swiss francs) and capital gains on the sale of qualifying participations of at least 10 per cent held for at least one year benefit from the participation deduction scheme under which such income is virtually tax-exempt.

Further, a Swiss acquisition company may benefit from a tax-neutral reorganisation in the sense of the Mergers Act (eg, a merger with the Swiss target company if required by the financing banks). Also, the Swiss target company can distribute dividends without withholding tax if the Swiss company holds at least 20 per cent in the Swiss subsidiary and the dividend is timely notified (except where 'old reserves' exist, see question 1).

It should be noted that the equity capitalisation of a Swiss acquisition company by its direct shareholder is principally subject to 1 per cent stamp duty (the first 1 million Swiss francs of contributed capital is exempt), whereas an indirect capital contribution (ie, equity funding not by the direct, but indirect shareholder) would generally not be subject to stamp duty. In case of a debt-financed acquisition, a Swiss acquisition company with mainly only dividend income may not benefit from tax-deductible interest expenses owing to its lack of taxable income. However, there are certain debt pushdown strategies available by which interest expenses can be allocated to a Swiss target company and be set off against its taxable income. Swiss thin capitalisation rules principally need to be considered if the acquisition company is funded by shareholder or related party debt (including third-party debt that is secured by shareholders or related parties). Interest on such debt is only tax deductible if certain debt-to-equity ratios are complied with and the interest does not exceed arm's-length terms. Generally, the debt funding of investments (shares) is limited to 70 per cent of the fair market value of such investment. As Switzerland has a broad treaty network, no CFC rules, an attractive income tax regime and usually offers possibilities to structure around potential tax inefficiencies, a Swiss acquisition company is often preferable.

#### 4 Company mergers and share exchanges

##### Are company mergers or share exchanges common forms of acquisition?

An immigration merger (inbound into the Swiss target) is possible based on the same provisions that apply for a Swiss domestic merger, that is one that can be carried out tax-free (ie, without taxable realisation of hidden reserves) if the following conditions are met: continued tax liability in Switzerland and transfer at current (tax) book value. The main question in case of an inbound merger is: will the foreign legislation permit such a merger and under what conditions? Furthermore, if a foreign company merged with a Swiss company has hidden reserves and the merger is made at (tax) book values, generally no step-up of the income tax values for Swiss tax purposes may be possible. This, however, may change with the StAF (see question 3). Swiss withholding tax may be triggered if the nominal share capital and qualifying capital contribution reserves in the Swiss merged entity increase or if reserves subject to Swiss withholding tax would be extinguished, such as if the merger is done with a company in a loss situation. Considerations for exiting Swiss shareholders are generally taxed like ordinary purchase price proceeds except if such considerations are paid by the merged company (taxed like dividends). Swiss individual shareholders holding the shares as private assets incur taxable income if they benefit from higher share capital or capital contribution reserves in the merged company.

A more popular alternative to an immigration merger is a quasi-merger as a share-for-share exchange between the acquiring and target companies, whereby the shareholders of the target company are compensated with (new) shares of the acquiring company. A tax-neutral quasi-merger requires that the acquisition company obtains at least 50 per cent of the voting rights of the target and the shareholders obtain at least 50 per cent of the value of the target in new shares of the acquirer (ie, the cash component may not exceed 50 per cent of

the value of the target). In case of a quasi-merger, the target remains a separate entity (as opposed to a statutory merger resulting in just one entity). In inbound cases (and the acquisition of a Swiss private entity), a foreign acquirer would typically set up a Swiss acquisition company, which would then acquire a Swiss target via share-for-share exchange based on the conditions outlined above. In this case, the Swiss acquisition company typically issues new shares to the tendering shareholders of the Swiss target company with a modest nominal share value and a large share issuance premium, which together reflect the market value of the acquired shares. The share premium may be booked and reported for Swiss withholding tax purposes as capital contribution reserves of the Swiss acquisition company, which could later be distributed free of Swiss dividend withholding tax. Such quasi-merger is exempt from the 1 per cent Swiss stamp issuance duty.

Qualifying quasi-mergers with Swiss target companies are in general tax-neutral for the acquiring and target entities. Swiss resident individual shareholders holding the shares of the target company as private, non-business assets are considered to realise a tax-exempt capital gain (or loss) upon the exchange (share and other consideration, if any). Swiss resident corporations or individuals holding the shares of the target company as business assets may be able to roll over their tax basis in the target company shares into the shares of the acquiring company provided the book values are continued.

For a public takeover, a triangular (quasi-) merger may often be a possibility, where the shareholders of an acquired company do not receive shares in the acquiring company, but shares of the top listed company instead. Following a public takeover, the target company may be merged with the acquiring (Swiss) company to squeeze out remaining shareholders (maximum 10 per cent).

#### 5 Tax benefits in issuing stock

##### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

For a Swiss acquisition company, the issuance of stock as consideration may be beneficial if the requirements for a tax-neutral quasi-merger are met (see question 4). In particular, at least 50 per cent of the fair market value of the Swiss target are compensated with (newly issued) shares of the acquisition company. Such quasi-merger is preferential for the Swiss acquirer as the contribution of the target shares will generally not trigger stamp duty, the acquisition of remaining target shares will benefit from a Swiss securities transfer tax exemption (see question 6, which could otherwise arise in a cash acquisition in case a securities dealer is involved in the acquisition) and the Swiss acquisition company can create capital contribution reserves that may be later distributed without Swiss dividend withholding tax. For Swiss sellers holding the shares in the target as business assets, the stock consideration may result in a deferral of the capital gain or rollover of the tax basis in the target shares.

#### 6 Transaction taxes

##### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

From a Swiss stamp duty perspective, the securities transfer tax of 0.15 per cent (ie, 0.075 per cent per party) on Swiss securities and 0.3 per cent (ie, 0.15 per cent per party) on foreign securities may arise in case of a share deal if a qualifying 'Swiss securities dealer' is involved in the transaction either as a party or an intermediary. The term 'Swiss securities dealer' includes not only professional securities traders, banks, brokers, asset managers and the like, but also all Swiss resident corporate entities whose assets consist, as per the last annual balance sheet, of taxable securities in excess of 10 million Swiss francs. A securities dealer involved principally has to pay:

- if he or she acts as intermediary: half of the burden for each party to the transaction that is not itself a registered securities dealer or exempt party; or
- if it is a party to the transfer: half of the burden for itself and half of the burden for its counter party that is not a registered securities dealer or exempt party.

Certain restructuring exemptions apply, but rarely in case of a transaction between unrelated parties. Swiss or foreign securities, such as bonds, shares or other securities that are sold in an asset deal may also be subject to Swiss securities transfer tax if a Swiss securities dealer is a party or intermediary in the transaction.

Further, most cantons or communes impose a real estate transfer tax upon a transfer of real estate (asset deal) and, in most cantons or communes, also in case of a share deal if a majority of shares in a real estate company is sold. The liability (buyer or seller) differs per canton and does not apply in case of tax-neutral reorganisations or mergers. In addition, real estate register fees and notary fees may arise on the transfer of real estate.

In case of an asset deal, the transfer of such assets is generally subject to 7.7 per cent (standard rate) or 2.5 per cent (reduced rate for certain assets) VAT except for assets that are not within the scope of VAT (eg, assets located abroad) or exempt from VAT (eg, receivables or real estate). VAT is generally payable by the transferor, unless the notification procedure applies or the transfer is made to a foreign acquirer (exemption for export of goods; export of services such as IP, which are taxable at the place of the acquirer). The transfer of real estate can be subjected to VAT unless the real estate is only used for private purposes. However, the VAT liability can in certain cases be fulfilled by applying the notification procedure, which must be applied if:

- both parties are subject to Swiss VAT;
- the VAT amount would exceed 10,000 Swiss francs or the assets are transferred intercompany; and
- the transfer qualifies as a tax-neutral reorganisation for corporate income tax purposes or concerns a transfer of a totality of assets or part thereof according to the Merger Act.

On a voluntary basis, the procedure may be applied if real estate is transferred or significant interest is proven (especially in case of a transfer of an organic business unit, a totality of similar assets or the assets to be transferred serving a similar business activity). This would apply in most cases between unrelated parties. As a consequence of the notification procedure, the acquirer takes over the same VATable basis and use for VAT purposes. That is, they could benefit from an additional input VAT refund or suffer from a repayment of input VAT refunded to the seller if the acquirer changes the use during the respective period (five years or 20 years for real estate).

A share deal typically is exempt from VAT without credit.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

Principally, a change in ownership of a Swiss entity in a share deal has no influence on the carry forward of tax losses, that is, losses from the past seven tax years can be carried forward and set off against the taxable profits of the actual period. There are exceptions, for example, if the acquired company has already been brought into liquid form and has no commercial activity anymore. In case of a financial restructuring or recapitalisation, the tax loss carry-forward is unlimited time-wise. Other tax attributes are principally also not affected by a change of control.

In case of an asset deal, any tax loss carry-forwards remain with the selling company and may be set off with a gain resulting from the sale (leading to a step-up to fair market value for the acquirer). There are principally no special rules for acquisitions of bankrupt or insolvent companies. A change of ownership has generally no impact if the Swiss target companies qualify for a special tax regime, like the cantonal and communal taxation regimes for holding, mixed or domiciliary companies (which will be abolished with the StAF) or the application of a partial tax relief (tax holiday) of a Swiss target company.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Interest payments in general are tax deductible and not subject to Swiss withholding tax at the level of a Swiss acquisition company. However, since there is no tax consolidation or group taxation for income tax purposes, the interest deduction is only tax efficient to the extent the acquisition company has its own taxable income. Otherwise, debt pushdown structures or the creation of taxable income at the acquisition company level should be considered.

Interest deduction limitations may apply to related party debt, that is, debt provided by shareholders, related parties or third parties where the debt is secured by related parties. Thin capitalisation rules set a limit for maximum loan amounts by shareholders or related parties that are accepted by Swiss tax authorities. The maximum amount of accepted debt is determined by applying the safe-haven rates (ie, a per cent amount of allowed debt per asset category, such as 100 per cent debt-financing for cash or 70 per cent for participations or IP), which are set out in a circular of the Federal Tax Authority. The percentages are applied onto the fair market value of the corporation's assets. Related party debt exceeding that maximum permitted debt calculated on this basis will be treated as equity for tax purposes; accordingly, interest payments on such exceeding debt will be treated as constructive dividends that are subject to 35 per cent Swiss dividend withholding tax and non-deductible from the taxable profit of the company.

Further, such deemed equity is also subject to annual capital tax. In order to avoid adverse withholding tax consequences, loans to the Swiss acquisition company may be granted interest-free, if this is possible from a lender's perspective. Such interest-free loan would – other than a subsequent waiver of interest – not trigger stamp duty of 1 per cent on equity contributions. Where the direct shareholder provides debt in excess of the thin capitalisation limitations but benefits from a full dividend withholding tax relief (eg, based on a double tax treaty or as Swiss resident corporation holding at least 20 per cent in the Swiss target), the withholding tax cash out could be avoided by a proactive, timely notification of the hidden dividend distribution.

In addition, interest on related party debt must comply with arm's-length terms. Circulars published annually by the Federal Tax Authority set out the maximum safe haven interest rates that may be paid by a Swiss company on shareholder or related party loans, generally with higher rates if the loans are denominated in foreign (non Swiss francs) currency. If the debt does not qualify as deemed equity (see above) and the safe haven interest rates are complied with, the interest is generally tax deductible. Higher interest rates may be accepted if the arm's-length character or a third-party test can be evidenced. This question can be addressed in a tax ruling to obtain certainty.

With respect to interest withholding tax, the Swiss '10/20/100 non-bank rules' need to be considered in case a bond is issued by a Swiss acquisition company or a 'collective fundraising' scheme is used. In this case, withholding tax of 35 per cent is levied on interest due that can be refunded based on Swiss domestic law for a Swiss lender or depending on the applicable double-tax treaty for a foreign lender. A loan facility qualifies as a collective fundraising where the aggregate number of non-bank lenders (including sub-participations) to a Swiss company under a facility agreement exceeds 10 (if granted under equal conditions) or 20 (if granted under different conditions, eg, various tranches or facilities), and the total amount of such debt exceeds 500,000 Swiss francs. Cash pooling does not amount to collective fundraising, unless the aggregate number of non-bank lenders exceeds 100 and the total amount of such debt exceeds 5 million Swiss francs. The Swiss withholding tax exposure under the 10/20/100 non-bank rules may be mitigated under certain conditions if acquisition debt is granted to a foreign entity and lent on to a Swiss subsidiary (acquirer). The borrowing via a foreign subsidiary of a Swiss parent could, however, trigger Swiss interest withholding tax, if the collective fundraising criteria are met by the foreign borrowing subsidiary, the Swiss parent guarantees the debt and the borrowed funds are lent on to a Swiss group company.

(based on recently introduced rules, there is an exemption to this treatment in case the foreign subsidiary does not lend more than its equity to a Swiss group company and in case the set-up is not considered a tax avoidance). Further, federal and cantonal Swiss withholding taxes on interest may arise if a loan is directly or indirectly secured by Swiss real estate; the tax rate depends on the location of the real estate. However, many Swiss double tax treaties reduce withholding taxes on interest to zero.

The tax-efficient pushdown of acquisition debt on the target level is not easy to achieve, as Switzerland has no consolidation for income tax purposes. A debt pushdown of acquisition debt by merging the acquisition company with the target company generally is viewed as abusive from a tax perspective by the Swiss tax authorities if the acquisition company had no taxable income to set off the interest expenses itself. Debt pushdown can typically per current practice be better achieved by strategic buyers (Swiss operating acquisition companies with their own taxable income) or by careful structuring. The distribution of debt financed dividends (leveraged dividends) whereby the target company resolves a dividend that is not directly settled in cash but left outstanding as an interest-bearing downstream loan towards the shareholder or settled by the assumption of external acquisition debt and the allocation of interest expenses to the target company may be possible, always within the limitations of the thin capitalisation rules. In addition, debt financed intercompany acquisitions, such as the acquisition of shares or assets from group companies by the Swiss target against an interest-bearing loan may be possible.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

Tax risks are usually addressed in the asset purchase agreement (APA) or share purchase agreement (SPA) in representations and warranties and a tax indemnity clause.

Historic tax risks remain with the target company in case of a share deal. A tax due diligence and the requesting of sufficient SPA protection for identified risks is thus highly recommended to an acquirer.

Typically, an acquirer asks for tax representations and warranties to be granted by the seller in the SPA for pre-closing periods in order to obtain general protection relating to tax compliance status, tax registrations, tax filings and tax payments as well as certain tax attributes and the absence of blocking periods, old reserves for withholding tax purposes, foreign permanent establishments or reversals of past depreciation of participations or loans. Tax indemnities are either granted for the pre-closing period or until a locked box date (depending on the purchase price mechanism) and either broadly for all taxes payable that are not already reflected in the purchase price (as debt) or only for specific risks identified. The goal of those clauses is to shift the liability for tax obligations originating from pre-closing periods back to the seller. Claims under a warranty or indemnity should principally be considered as a purchase price reduction between acquirer and seller and would be income tax neutral and as such not subject to withholding tax. Direct claims by the target against the seller could result in taxable income. Even if the payment would be structured as contribution via the purchaser, 1 per cent stamp duty on the contribution into the Swiss target could be triggered. Thus, both should be avoided and the indemnification should be made between acquirer and seller.

An acquirer in an asset deal can be liable for certain taxes, like VAT, customs and social security contributions and potentially payroll taxes and should seek protection in the APA. Claims from acquirer against seller would usually be a purchase price reduction and may reduce the capital gain for the seller and step-up (depreciation basis) for the acquirer. No withholding taxes should arise on such payments, but transfer taxes and VAT may need to be adjusted accordingly.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

A post-acquisition merger of the (Swiss) acquisition vehicle and the acquired company is often contemplated and can generally be done on a tax-neutral basis. The benefit is the integration of the acquired business by combination with the existing business of the acquirer in Switzerland, the reduction of legal entities and the faster access to operating cashflow in the target entity irrespective of distributable reserves. The latter is often requested from financing banks, as the bank debt is then on the level of the target company and directly secured by the target's assets.

From a tax perspective, such merger can have the benefit of offsetting taxable profits of the operative target business with interest expenses from the acquisition financing. However, if the acquisition company does not have its own taxable income, such offsetting is usually not permitted by the Swiss tax authorities but seen as abusive after a merger (debt pushdown). Even if this tax benefit is not achieved, the merger can be done for the abovementioned reasons.

If the Swiss target entity has been acquired from Swiss resident individuals and the indirect partial liquidation rules apply, a merger with the acquisition company within five years after the transaction would trigger the income taxation for the sellers as if the target entity had distributed its reserves to the sellers. Depending on the amount of taxes triggered and whether the acquirer would be liable according to the SPA for such taxes towards the sellers, no merger with the acquisition company should be performed during five years after the transaction; side-stream mergers or mergers within the target group, in contrast, should generally not trigger the indirect partial liquidation taxation.

A merger of the Swiss acquirer with a Swiss target that had been held by non-Swiss shareholders or shareholders not being entitled to a full withholding tax reductions on dividends from the Swiss target should be carefully analysed as it could trigger non-refundable Swiss withholding taxes on the amount of the purchase price less share capital and potential capital contribution reserves ('liquidation by proxy').

Additionally, intragroup transactions in the acquired target group may be used in certain cases to generate distributable reserves (eg, an intragroup transfer of a participation to another group company at fair market value with the potential capital gain being subject to the participation deduction if the required conditions are fulfilled), which may then be used to upstream cash to the acquisition company and further.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

A tax-neutral demerger of a Swiss company may be carried out in the form of split-up or spin-off and is principally tax-neutral (ie, no taxable realisation of transferred hidden reserves) under the following cumulative conditions:

- the tax liability of the companies continues in Switzerland;
- one or more business or business units are transferred;
- the transfer is done at (tax) book value, against sufficient equity; and
- both Swiss entities continue their businesses after the demerger.

Under these conditions, a demerger does not further trigger any transfer taxes, like securities transfer tax or real estate transfer tax. Registration fees or notary fees upon the transfer of real estate may still apply.

Because the demerger is not subject to any blocking period, it is often used by sellers as a pre-deal structure opportunity in order to transfer a business unit to a new entity and sell it through a share deal.

The demerger can be structured in different ways, for example, as direct demerger (split of a legal entity) under the Merger Act or as contribution of the business unit into a new subsidiary and distribution of the shares in the new subsidiary to the shareholders.

In order to be neutral for stamp duty purposes, certain restrictions regarding the maximum amount of newly created share capital at the level of the new entity need to be considered.



Other ways to achieve, under certain conditions, a tax-neutral spin-off include the transfer of (partial) business or operating fixed assets to a Swiss subsidiary, Swiss parent or sister company, however, always subject to a five-year blocking period. The transfer of participations to a Swiss or foreign subsidiary can generally be done tax neutrally and is not subject to a blocking period.

Usually, a tax loss carry-forward can be transferred with the tax-neutral transfer of a (partial) business unit if and insofar as the loss is related to the business activity of the transferred unit. Otherwise, the tax loss carry-forward remains with the transferor. Thus, it is recommended to confirm the allocation of the tax loss carry-forwards in a tax ruling with the competent tax authorities.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

In general, a migration of a company from Switzerland is considered a deemed liquidation, triggering the same tax consequences as a statutory liquidation process. In particular, hidden reserves (fair market value less tax book values of business of the company) would be subject to income tax at the applicable tax rate of the Swiss company. Furthermore, the 'liquidation surplus' (net assets at fair market value, minus nominal share capital and recognised capital contribution reserves) would be subject to 35 per cent dividend withholding tax: depending on the domicile of the shareholders of the former Swiss entity and the applicable double tax treaties, the withholding tax may be notified instead of paid or partially or fully refunded. No income tax will generally be due, if the business activity of the Swiss entity is continued upon the migration through a permanent establishment in Switzerland and the book values are carried on and remain subject to Swiss taxation based on the international allocation between foreign headquarter and Swiss permanent establishment. However, withholding tax on the liquidation surplus will still be due (see above).

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Dividends paid by a Swiss company are principally subject to a withholding tax at a rate of 35 per cent. However, this withholding tax may be fully reclaimed by a Swiss tax resident shareholder or may also be notified by a Swiss corporate shareholder holding at least 20 per cent in the Swiss company to the Swiss Federal Tax Authority (in order to avoid a temporary cash-out) within a certain timeline. While dividend withholding tax is meant to be a final burden to non-Swiss resident beneficiaries, full or partial relief may be available under an applicable Swiss double taxation treaty. Also in the cross-border context, the notification procedure for dividends paid to a qualifying corporate shareholder (owning at least 10 per cent of the equity of the distributing Swiss entity or the percentage required under the applicable tax treaty and meeting all further conditions for treaty benefits) may be applicable. It requires the previous filing of a specific application form with the Federal Tax Authority and the demonstration that the foreign beneficiary fulfils all conditions for the requested tax treaty benefits. The repayment of qualifying capital contribution reserves or share capital is not subject to dividend withholding tax.

On interest payments, there is generally no withholding tax levied in Switzerland, with the exception of interest payments on qualifying bonds or collective fundraisings (see question 8 regarding 10/20/100 non-bank rules) and on interest paid on bank deposits (with the Swiss entity qualifying as a bank under the Swiss withholding tax provisions) exceeding a defined minimum amount. Further, withholding tax may apply if the loan is secured by Swiss real estate (see question 8). Dividend withholding tax may apply on intercompany interest if the interest qualifies as hidden dividend distribution (in case the Swiss entity is thinly capitalised or the interest exceeds the arm's-length terms).

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

In addition to dividends and interest, other intercompany payments could be considered to extract profit from the Swiss entity. Such payments need to comply with arm's-length terms to be accepted from a tax perspective. Switzerland usually follows the OECD transfer pricing guidelines in this respect.

There is no Swiss withholding tax on royalties or management fees. Accordingly, it would be possible to extract profits by such payments provided they are at arm's length.

## Disposals (from the seller's perspective)

### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

Usually the seller has an interest to carry out the disposal by selling the stock of the company or of the foreign top company: a Swiss resident individual holding the shares as private assets can benefit from a tax-exempt capital gain when selling these shares (see question 1 regarding indirect partial liquidation risk). In contrast, the sale on a lower level or an asset deal would require the repatriation, which is subject to dividend taxation (fully taxable income or privileged taxation in case of a shareholding of minimum 10 per cent), a Swiss company holding at least 10 per cent in the Swiss target for at least 12 months will also prefer a share deal to benefit from the participation deduction (virtual tax exemption).

To the extent the foreign holding company is in a jurisdiction with a favourable double-tax treaty with Switzerland, the sale of shares by the foreign holding company followed by a dividend distribution to Swiss corporate shareholders can also be a tax efficient structure. Provided the dividends are not subject to foreign withholding tax, the Swiss shareholder can benefit from the participation deduction on dividends if its shareholding in the foreign holding is either at least 10 per cent or has a fair market value of at least 1 million Swiss francs (no minimum holding period applies to dividends).

An asset deal is generally less beneficial for a seller as it triggers a taxable gain for the seller. It may be considered if the seller has a tax loss carry-forward that would otherwise forfeit, the seller can make use of a deferral (re-investment relief for certain operating assets) or if the seller benefits from a low or privileged taxation and receives a higher purchase price by the acquirer due to the buyer's step-up and depreciation.

### 16 Disposals of stock

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Based on Swiss unilateral law, irrespective of a double tax treaty, Switzerland does not impose tax on the gains of the disposal of stock in a local company by a non-resident seller (ie, a foreign seller without permanent establishment and without place of management in Switzerland).

One important exception applies at the cantonal or communal level where the share deal equals an indirect transfer of local real estate, such as the direct or indirect sale of a majority interest in a real estate company, (ie, a company that predominantly owns Swiss real estate for investment purposes). The exact qualification criteria for a real estate company vary between the cantons. Further, depending on the application of a double tax treaty between Switzerland and the residency of the seller, the taxation right of Switzerland may be restricted, for example, currently under the double tax treaties with Luxembourg, Denmark or Germany. However, the majority of the Swiss tax treaties reserve the right of the contracting state in which the real property is located to tax indirect gains upon the sale of company shares, if more than 50 per cent of the company's assets are comprised of local real property.

With regard to energy and natural resource companies, there are no special tax rules in Switzerland.



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**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

As outlined above, a sale of all shares in the local company would be either tax exempt (in the case of a Swiss individual holding the shares as private assets and not qualifying as securities trader) or virtually exempt, subject to the requirements of the participation deduction, at the level of a Swiss tax-resident company.

Business-required long-term assets can qualify for a deferral or rollover relief to the extent that the proceeds are re-invested within a certain time frame in the acquisition of other long-term assets. The sale proceeds of real estate cannot be rolled over to movable long-term assets.



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# Turkey

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

The most significant differences in local tax treatment between a share deal and the acquisition of business assets and liabilities are the application of value added tax (VAT), income tax exemptions and accounting of goodwill. In most share deals, the transaction is exempt from (or not subject to) Turkish VAT, and corporate and individual sellers benefit from income tax exemptions on capital gains, if any, while the acquisition of business is usually a taxable transaction in terms of Turkish VAT and income taxes.

In case of business acquisitions, in principle, the VAT applies at relevant rates varying between 1 per cent and 18 per cent over the market value of the concerned assets. Generally, the VAT is calculated and declared by the seller and reimbursed from the purchaser. Under the local VAT offsetting mechanism, such input VATs can be recovered by the purchaser by way of offsetting them against the output VATs.

The goodwill, on the other hand, is expected to be a positive amount that represents the difference between the deal price (ie, the consideration for the business acquisition) and the market value of the concerned assets. The transfer of goodwill is subject to VAT at the general rate of 18 per cent, which is the highest VAT rate applicable in Turkey, and there is no exclusive income tax exemption for the goodwill.

Furthermore, as per recent regulations, the agreements executed for the transfer of stock in certain Turkish companies are exempt from stamp duty, which is a unique type of local document tax with a potential cost of around US\$332,000 (as per current exchange rates) per each legal instrument. Usually there is no stamp duty exemption applicable for the agreements, deeds or protocols executed for business acquisitions; stamp duty may therefore be an incremental burden to be calculated at approximately 1 per cent over the deal price. For 2018, the general rate of stamp duty is 0.948 per cent (almost 1 per cent) and the base for taxation is generally the highest monetary amount referred to in the agreement (eg, the consideration, the deal price).

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

There is no step-up for the concerned assets (or generation of goodwill) in share deal transactions, unless the seller (pre-acquisition) or the purchaser (post-acquisition) opts to have a revaluation made at the level of the target company (ie, as a separate accounting process).

In case of business acquisitions, however, all the concerned assets are transferred at their market price, which usually leads to a step-up in basis at the level of the purchaser company either because they were booked at their historical value under the relevant local generally accepted accounting principles (GAAP) or because they were fully depreciated. In addition to such step-up, the useful life of each of the

concerned assets will be restarted at the level of the purchaser company for the purposes of tax-oriented depreciation.

Because its transfer and related income are subject to value-added tax and income tax, respectively, from a local tax perspective, a positive amount of goodwill (which represents the difference between the deal price and the market value of the concerned assets) is expected to be generated in business acquisitions. Accordingly, in case of business acquisitions, such goodwill can be depreciated for tax purposes at the level of the purchaser company as is the case with all other intangible assets required for the generation of commercial income and maintenance of business activities.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

In cases of business acquisition, it is always preferable for the transaction to be executed by an entity (eg, a branch or a subsidiary) established in Turkey because generation of income within a fiscal unit (post-acquisition) requires a tax-registered local entity to be established in Turkey. It is not practical for a foreign (or non-resident) company to deal with tax compliance, social security or foreign trade activities without having a locally established legal entity even though theoretically it could be possible for a permanent establishment registered for tax purposes to carry out business in Turkey.

Usually incorporating a joint-stock company is preferred by the investors, compared to a limited liability company, due to its broader tax benefits in case of an exit in the future. Briefly, having a subsidiary, such as a joint stock company, incorporated in Turkey may serve to eliminate most local taxes through a share deal, for example, if the investor intends to fully or partially exit their investment after a certain period of time. In case of such a future share deal, it may be possible to have VAT and stamp duty exempt and to significantly reduce income tax on capital gains, if any.

Regarding the share deal transactions, on the other hand, foreign investors do not generally prefer to have a Turkish entity to execute the acquisition of stock in the target company because there is no fiscal unity (or tax consolidation) in Turkey and each additional layer of incorporation leads to a one-year lag in upstream dividend distribution from the target company, as an interim dividend distribution mechanism does not work as efficiently as a year-end distribution.

In opposition to the aforementioned general preference, there have been share deals where foreign investors opted to have local acquisition companies, such as JVs and SPVs, execute the transactions. These particular examples were involving special motivations such as having local partners directly contribute into the joint venture or satisfying certain requirements in the bilateral income tax treaties to which Turkey is a party.

### 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Although they can be carried out free of tax, company mergers or share exchanges are not common forms of acquisition in Turkey because neither of these forms permits the investors to acquire significant interest

in the target company without entering into two-way exchange of stock in other companies. These two forms are preferred for internal group restructuring or for post-acquisition structuring purposes if the investors have other companies in Turkey.

Regarding the share deals in Turkey, the most common form of acquisition is transfer of stock in the target company in return for cash consideration since the capital gains, if any, are either wholly or mostly exempt from income taxation in the majority of the transactions.

## 5 Tax benefits in issuing stock

### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

There is a specific type of share-swap regulated under the Corporate Income Tax Law, according to which acquisition of majority interest (ie, shares and management) in a capital company by a Turkish capital company can be exercised by way of delivering newly issued stock in the acquirer company to the sellers as consideration rather than cash. As per the law, the accounting gains arising from the exchange of shares are exempt from taxation. This particular form of transaction might be preferred for internal group restructuring or for post-acquisition structuring purposes. Although there is no specific valuation methodology provided by Turkish tax laws for the determination of share exchange ratio, it is expected to be a reasonably practicable one in order to ensure an arm's-length transaction.

Apart from the aforementioned share-swap scheme, Turkish tax laws do not provide for any specific tax benefits to the acquirer issuing stock as consideration rather than cash. On the contrary, if the aforementioned share-swap mechanism is not the case, the acquirer's issuing stock as consideration may jeopardise a Turkish corporate seller's qualification for income tax exemption for capital gains, if any, because one of the conditions for benefitting from such corporate income tax exemption is to have the sale proceedings fully collected in a given period of time, and in cash terms. As per the secondary regulation, even cash-equivalents, such as stocks listed in Borsa Istanbul Stock Exchange, delivered by the acquirer as consideration have to be converted into cash by the Turkish corporate seller within such given period of time if concerned income tax exemption is elected. Otherwise, the underpayment of income tax will have to be compensated by the seller with late payment interest.

## 6 Transaction taxes

### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Turkish stamp duty is a unique type of document tax where the subject matter of taxation is the concerned legal instrument (or the 'paper', as referred to in the law). In other words, the acquisition, in and of itself, is not subject to taxation because stamp duty is not a transaction tax. However, if an agreement is executed for the acquisition in Turkey, it is, in principle, subject to stamp duty at a rate of 0.948 per cent (determined for 2018) over the highest monetary amount that is externally computable or referred to therein – generally the monetary base is the deal price.

As per recent regulations, the agreements executed for the transfer of stock in certain Turkish capital companies are exempt from stamp duty. Stamp duty could amount up to around US\$332,000, which is the US dollar equivalent of the stamp duty cap determined for 2018 per each legal instrument. Usually there is no stamp duty exemption applicable for the agreements, deeds or protocols executed for business acquisitions; stamp duty may therefore be an incremental burden to be calculated at approximately 1 per cent over the deal price.

Generally, the share deal transactions are exempt from (or not subject to) VAT in Turkey. In case of business acquisitions, on the other hand, in principle the VAT applies at relevant rates varying between 1 per cent and 18 per cent over the market value of the concerned assets – the transfer of goodwill is subject to VAT at the general rate of 18 per cent. Generally, the VAT is calculated and declared by the seller and reimbursed from the purchaser. Under the local VAT offsetting mechanism, such input VAT can be recovered by the purchaser by way of offsetting them against the output VAT.

## 7 Net operating losses, other tax attributes and insolvency proceedings

### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

The net operating losses, tax credits or other types of deferred tax assets are not subject to any limitations after a change of control of the target company or in any other circumstance such as insolvency. On the other hand, a certain portion or amount of the carried-forward previous years' losses may have to be waived if the concerned fiscal unit is terminated and merged into another company or certain tax amnesty provisions are opted in. In order to preserve most of the carried-forward tax losses in mergers, merging the other fiscal unit into the company with the most losses could be a tax-efficient strategy.

Turkish tax laws do not provide for any specific rules and there is no special tax regime for the acquisition of bankrupt or insolvent companies. As a general rule, however, reorganisation of such companies, such as by merger or demerger, is expected to be solution-oriented (eg, to cure the insolvency).

## 8 Interest relief

### Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

In principle, acquisition-related financing expenses (ie, interests and foreign exchange losses) incurred at the acquisition company level are tax deductible. In case of business acquisitions, the financing expense would be a tax shield against the operation income at the acquisition company level. On the other hand, in case of share deal transactions, where there would be an acquisition company and a target company in the picture, the financing expenses of the acquisition company and the operation income of the target company cannot be consolidated because there is no fiscal unity or tax consolidation mechanism in Turkey. Thus, generally, acquisition-related financing expenses to be incurred at the acquisition company level cannot be utilised effectively.

Furthermore, deduction of acquisition-related financing costs through a post-acquisition merger (ie, debt pushdown) is not allowed, and local tax authorities would likely challenge such a tax-oriented reorganisation if such financing expenses are not accounted for as 'non-deductible expense' post-merger.

The deduction of financial expenses may not be allowed if it is subject to thin-capitalisation or transfer pricing restrictions apply in cases of borrowing from related parties. Generally, if the amount of related party loan exceeds three times the shareholders' equity of the acquisition company (ie, borrower), along with some other unfavourable tax implications, the exceeding portion is re-characterised as thin capital and the financial expenses corresponding to the thin capital will not be deductible for corporate tax purposes, as is the case with any overstated payment to related parties made against the arm's-length principle.

Turkey recently introduced a favourable allowance for partial deduction of 'notional interest' as a tax incentive measure for capital increases in the form of cash. So, in case of business acquisition, a Turkish acquisition company, which is also an operating company deriving business profits, is able to deduct 50 per cent of the notional interest. In case of share deal transactions, on the other hand, the acquisition company cannot benefit from such allowance because it is an intermediary holding company mainly deriving passive income.

Under the local legislation, interest payments to foreign (or non-resident) corporations (other than banks or financial institutions) are subject to Turkish income tax through withholding at a rate of 10 per cent, whereas the rate is reduced to zero per cent if the loans are extended by qualified financial institutions or banks.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

All generally accepted forms of protection measures can be used during share deals and business acquisitions. Generally, the buyers seek warranties and indemnities in share deals for all the previous tax periods prior to the acquisition. This mainly includes cooperation in good faith, indemnification of tax claims by the authorities and the accuracy of on-balance-sheet and off-balance-sheet deferred tax assets.

As per the established practice, payments in relation to a warranty or indemnity claim are considered price adjustments and treated for tax purposes accordingly.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

A typical example of post-acquisition restructuring is the merger of the target company with another group company or the acquirer company in Turkey, if any. Given the facts that there is no fiscal unity (or tax consolidation) in Turkey and each additional layer of incorporation leads to a one-year lag in upstream dividend distribution, post-acquisition restructuring generally aims for simplification of shareholding and financing schemes in Turkish companies.

Regarding the restructuring of financing schemes at the level of the acquirer company or the target company, the investors usually tend to replace the existing debt with their preferred lending arrangements. As part of the restructuring of the financing scheme, investors have to work on the debt-to-equity ratios based on their preferred working capital mix, the capital insolvency requirements in the Turkish Commercial Code, and the restrictions in the local tax laws.

### 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Tax neutral spin-off transactions (or demergers) are relevant only if the concerned fiscal unit could be split into different lines of business. They could be structured as full or partial demergers: all assets of the splitting company are spun off to two or more new or existing companies; or only one or several lines of business could be spun off, with the splitting company also retaining part of the ongoing activities. The partial demerger, where the splitting company retains part of the ongoing activities, is usually the preferred form of tax neutral spin-off transaction.

In case of partial demerger, the carried-forward previous years' losses that could be associated with spun-off business lines are not transferred; however, they can be preserved at the splitting company level.

There is an exclusive exemption in the stamp duty law for tax neutral merger and demerger agreements. As a result, not only is the transaction exempt from income taxes and transactional taxes, but all related transaction documents are also exempt from stamp duty in Turkey.

From a legal standpoint, there will be a universal transfer of all obligations and liabilities related to the spun-off business(es). From a tax standpoint, the receiving company will be jointly and severally liable with the splitting company for the tax liabilities related to the pre-demerger period; this liability is capped at the market value of the spun-off assets.

Cross-border demergers (ie, direct demergers of an entity incorporated in Turkey to an entity incorporated elsewhere) are not possible.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

It is not possible to migrate the residence of a locally incorporated acquisition company (or target company) from Turkey because incorporation is considered a measure of residence for Turkish tax purposes.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

Interest accruals in relation to loans obtained from non-resident companies (other than qualified financial institutions and banks), are subject to withholding tax at a local rate of 10 per cent. Should the lender be a qualified non-resident financial institution or bank, as per the law, the applicable rate is reduced to zero per cent. Any relief or provision of bilateral income tax treaties to which Turkey is a party is reserved.

Companies in Turkey can freely distribute their after-tax profits provided that they have sufficient profits to cover all the accumulated losses from previous fiscal periods, if any, and the legal reserves are set aside at the distributing company level. As per Turkish tax laws, dividends distributed to non-residents and individual shareholders are subject to income tax through withholding at a local rate of 15 per cent, as is the case for upstream income repatriation by the Turkish branches of non-resident companies. The rate may be reduced by virtue of bilateral income tax treaties to which Turkey is a party, subject to certain conditions such as the beneficial ownership test.

Dividend distribution between Turkish entities is not subject to local income taxation.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Non-resident companies are allowed to establish branch offices, carry out business activities through such fiscal units and are taxed as limited taxpayers in Turkey under similar principles with Turkish companies. Branch offices could be preferred by foreign investors if, for example, their intention is not establishing a joint venture, having a partner in shareholding, or exiting their investment through a share deal.

For certain jurisdictions, upstream profit repatriation from the Turkish branch to its non-resident principal may be exercised quite tax-efficiently (ie, at relatively low rates, compared to dividend distribution by Turkish companies) by virtue of bilateral income tax treaties between Turkey and the jurisdiction of which the principal is a resident.

## Disposals (from the seller's perspective)

### 15 Disposals

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

The common form of disposal transactions carried out in Turkey is the disposal of stock in the local company (ie, share deal) because of tax and legal reasons. Unlike the requirement of separately dealing with the transfer of each single business asset (eg, at the relevant registries, under separate agreements), legally a share deal is the most straightforward and least burdensome way of disposing of the assets sitting in a local company. Even from an ultimate individual seller's tax perspective, a share deal is usually the most tax-efficient and least expensive way because extracting the proceeds from the local seller company often has significant tax costs.

Disposal of stock in the foreign (or non-resident) holding company by another foreign company does not have any tax implication in Turkey. This type of disposal takes place in global acquisitions where the purchaser company acquires interest in subsidiaries in a number of jurisdictions, so a share deal at a higher level provides simplicity and efficiency.



**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

In many cases, if the acquirer is also a non-resident company, it may be argued that gains derived by non-residents on disposal of stock in the local companies, if any, are not subject to income taxation in Turkey in the first place. Should the transaction fall within the scope of Turkish income taxation, foreign investors usually benefit from a treaty relief or they just consider it an extensive local tax shield. As per the treaty relief in question, which is stipulated in most of the bilateral income tax treaties to which Turkey is a party, Turkey does not have taxation rights in relation to the concerned gains if the non-resident seller has been holding the concerned stock for a period of more than one year.

There are no special rules in tax laws dealing with the disposal of stock in real property, energy or natural resource companies. Any special provision of bilateral income tax treaties to which Turkey is a party is reserved.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Although there is a similar tax-free rollover regime regulated for certain Turkish taxpayers that serves avoiding income taxation on the disposal of assets, we do not think it is relevant for deferring or avoiding tax in relation to the concerned disposal of shares or business assets. The local tax regime in question simply requires replacement of the economic asset with a new model that possesses identical specifications.

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# United Kingdom

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

Whether a share acquisition or a business acquisition is more attractive to a potential purchaser from a tax perspective will depend on the facts, taking into account the nature of the relevant assets and liabilities of the business and what the purchaser intends to do with the business following its acquisition (eg, whether or not it intends to seek to sell on the assets or shares to a third party shortly after the acquisition).

Tax liabilities of a target company carrying on the business will remain with the target following an acquisition of shares in that company and, as a consequence, a purchaser will seek protection from the seller for pre-completion tax liabilities of the target, both known and unknown (see question 9). The target's historic base cost in its assets is unaffected by the transfer of ownership of its shares. Given that this is likely to be lower than the base cost the purchaser would acquire if it had instead purchased the assets from the target, if the purchaser intends to strip out and sell on the assets it would be preferable for the purchaser to purchase the assets themselves rather than shares in the target. Other tax attributes of the target also remain, in particular any tax losses continue to be available to set off against future profits (subject to various restrictions and anti-avoidance rules, see question 7).

A key attraction for a purchaser of acquiring business assets from the target rather than shares in the target itself is the ability to claim capital allowances (assuming the assets of the business include plant and machinery or other assets for which capital allowances may be claimed) and obtain tax relief for expenditure on intangible assets (but see question 2), rather than being confined to an inherited tax position.

### 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

Where a purchaser acquires business assets, the amount paid for such assets (plus the incidental costs of acquisition) will generally constitute the purchaser's new base cost in such assets for the purpose of calculating its chargeable gain on any future disposal. This is subject to a market value override that applies to transactions between connected parties.

There used to be a favourable regime for the acquisition of goodwill and other intangible assets enabling a purchaser to benefit from corporation tax deductions when expenditure on these assets was recognised in the accounts. This provided a significant incentive for a purchaser to acquire business assets from a target company rather than shares in the target. This relief was removed for expenditure on goodwill, and certain other intangible assets linked to customers and customer relationships, acquired on or after 8 July 2015. However, the UK government is currently conducting a review of the taxation of intangible fixed assets, and is considering whether some form of relief for goodwill amortisation may be reintroduced. Investment in intellectual property and

certain other intangible assets continues to benefit from relief in line with the purchaser's accounting treatment.

Where a purchaser acquires shares in a target company, there is generally no step-up in basis available in respect of the assets of that target company. However, a step-up can occur in circumstances where a degrouping charge is triggered: if another company in the seller's group had transferred capital assets or certain intangible fixed assets to the target within the six years before the purchaser acquires the target, a degrouping charge will be triggered upon the acquisition of the target by the purchaser and the target will be deemed to have disposed of, and immediately re-acquired, the relevant assets at market value at the time of the degrouping.

The draft Finance Bill 2019 includes an amendment to implement the EU Anti-Tax Avoidance Directive (ATAD), which provides that where a capital asset or intangible fixed asset is subject to an exit charge in an EU member state upon coming within the UK tax net, it will be treated as having been acquired at market value at the point the exit charge is applied. This ensures that any gain is not also subject to UK tax, avoiding potential double taxation. The amendment is expected to take effect as of 1 January 2020.

### 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

The UK has generally been regarded as a favourable holding company jurisdiction (for non-banking groups):

- with a corporation tax rate of 19 per cent, expected to decrease to 17 per cent by 2020, it has one of the lowest corporate tax rates in the G20;
- the dividend exemption should generally be available, irrespective of whether the holding company's shareholder is resident in the UK or elsewhere;
- a UK acquisition company should generally be able to benefit from deductions for the finance costs of acquiring the target (subject to the restrictions explained in response to question 8); and
- the substantial shareholding exemption (SSE) would enable a UK acquisition company to dispose of the target without triggering a chargeable gain if the conditions are satisfied (see question 15).

A key issue for business is whether the UK's exit from the EU is likely to have any adverse impact on the attractiveness of the UK as a location for a holding company, or an intermediate holding company, from a tax perspective. While there may be some changes relevant in certain fact patterns, in the majority of cases the attractiveness of the UK's tax regime is likely to be unaffected and may even be improved as the UK seeks to retain the inward investment it already has and aims to encourage further investment. It is worth noting that if, as is likely, UK resident companies lose the benefit of the Parent-Subsidiary Directive and the Interest and Royalties Directive, the UK's extensive tax treaty network is well placed to protect a UK holding company from withholding tax on dividends, interest and royalties received from most European jurisdictions. There is potential for some tax leakage where the UK's treaties do not reduce withholding taxes to zero, but it is expected that groups should be able to restructure appropriately ahead of the UK's ultimate exit on 29 March 2019.

#### 4 Company mergers and share exchanges

##### Are company mergers or share exchanges common forms of acquisition?

Since the EC Mergers Directive was implemented in the UK in December 2007, it has been possible to effect a 'true' merger in which all the assets and liabilities of a transferor company are transferred to a transferee company and the transferor company thereupon ceases to exist without needing to be put into liquidation.

The UK regulations implementing the Directive require at least two companies from different EU member states to be merged, and allow for three types of cross-border mergers: merger by absorption, merger by absorption of a wholly owned subsidiary or merger by formation of a new company. The procedure as implemented in the UK involves a number of court hearings, which has implications for the timetable of the proposed acquisition.

This procedure is not commonly used, and there are no other means of achieving a 'true' merger in the UK. Whether these rules are amended so as to apply post-Brexit depends on the deal negotiated with the EU.

Share exchanges are, however, common forms of acquisition and can enable the seller to roll over any chargeable gain into shares or loan notes issued by the purchaser.

#### 5 Tax benefits in issuing stock

##### Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

The purchaser does not obtain a tax benefit from the issuing of shares as consideration.

#### 6 Transaction taxes

##### Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

###### Share acquisition

Stamp duty at the rate of 0.5 per cent of the consideration is payable on the acquisition of shares in a UK company. Stamp duty reserve tax (SDRT) is charged on an agreement to transfer shares in a UK company at the rate of 0.5 per cent of the consideration. Where an agreement to transfer such shares is completed by a duly stamped instrument of transfer within six years of the date when the SDRT charge arose, there is provision in many cases for the repayment of any SDRT already paid, or cancellation of the SDRT charge. A higher rate of 1.5 per cent SDRT is imposed if shares or securities are transferred (rather than issued) to a depositary receipt issuer or a clearance service and the transfer is not an integral part of the raising of share capital. The 1.5 per cent stamp duty 'season ticket' charge on issue is still on the UK's statute books but is not collected by HMRC as it has been found to be contrary to EU law (the Capital Duties Directive). The Capital Duties Directive will cease to apply to the UK upon leaving the EU but the UK government confirmed in the Autumn Budget 2017 that it did not intend to impose the 1.5 per cent charge following Brexit.

Prior to March 2015, takeovers of UK companies were frequently implemented by way of a cancellation scheme (the target's shares were cancelled and shares were issued by the acquirer to the target shareholders). There is no stamp duty on a cancellation of shares (as there is no instrument of transfer), so this enabled the transfer of ownership of a UK target without needing to pay any stamp duty. However, since March 2015 it is no longer possible for an acquirer to use a cancellation scheme to effect a takeover – acquirers must instead use a transfer scheme of arrangement or a contractual offer (on which stamp duty or SDRT is payable). Attempts continue to be made to effect takeovers without triggering stamp duty, and this is an area where HMRC is keen to react swiftly with anti-avoidance legislation.

The acquisition of shares is not a supply for VAT purposes.

###### Acquisition of business assets

If business assets are acquired, stamp duty land tax (SDLT) will be payable on transactions in UK land (although land in Scotland is subject to a separate land and buildings transaction tax rather than SDLT and from April 2018, the newly introduced Welsh Land Transaction Tax

replaced SDLT in Wales). Where the consideration exceeds £250,000 the top rate of SDLT on transactions in non-residential property is 5 per cent. If the business assets include an interest in a partnership that holds stock or marketable securities, stamp duty at 0.5 per cent will apply to the transfer of the partnership interest.

Most supplies of land are exempt from VAT, unless the seller has opted to tax the land. If the transfer of assets meets the conditions for being a transfer of a business as a going concern, there will be no taxable supply for VAT purposes.

#### 7 Net operating losses, other tax attributes and insolvency proceedings

##### Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

There are anti-avoidance rules that can deprive a company of, or restrict its use of, carried-forward losses after a change of control of that company. There are also restrictions on how carried forward losses can be used, which apply irrespective of change of ownership.

###### Carry-forward of losses – general rules

Under the second Finance Act of 2017, the UK introduced new rules on loss relief that apply retrospectively from 1 April 2017. These reforms deliver greater flexibility on the use of carried-forward losses, but reduce the amount of taxable profits that can be offset by such losses. In summary, under the new rules:

- losses incurred on or after 1 April 2017 can be carried forward and set off against profits from other income streams and against profits from other companies within a group; but
- from 1 April 2017, the amount of taxable profit that can be offset by carried-forward losses (whenever incurred) is restricted to 50 per cent (although this only applies to taxable profits in excess of £5 million calculated on a group basis).

Under the pre-1 April 2017 rules, trading losses can be set off against profits in the same or the previous accounting period, or (subject to satisfaction of various conditions) be surrendered by way of group or consortium relief. To the extent that pre-1 April 2017 trading losses remain unused, they will be carried forward but may only be set against profits of the same trade in subsequent accounting periods.

Under both the old and new rules, no time limits apply to the carry-forward of losses, and if a company transfers its trade to another member of its group the transferee will, subject to anti-avoidance rules, inherit the tax losses of the transferor, unless the transferor is in liquidation.

The reforms have created a very complex, dual regime that requires companies to consider carefully the way they use their losses. It is particularly harsh that pre-1 April 2017 losses do not benefit from the increased flexibility (so, for example, carried forward trading losses can only be set against profits of the same trade in subsequent accounting periods) but, if set off against post-1 April 2017 profits, will be subject to the restriction on the amount of profits they can be set against.

The draft Finance Bill 2019 includes a number of minor amendments intended to ensure that the new carry-forward regime operates as intended.

###### Carry-forward of losses – banks and building societies

Banks and building societies have been subject to a restriction (the bank loss restriction) since 1 April 2015 on the carry-forward of trading losses, non-trading loan relationship deficits and management expenses. Initially, 50 per cent of their taxable profits in any accounting period could be offset by these carried-forward amounts (subject to a £25 million allowance for groups headed by building societies or savings banks). This was cut to 25 per cent from 1 April 2016 and from 1 April 2017 banks have also been required to operate the proposed new carry-forward loss restriction (outlined above) to losses that fall outside the scope of the existing bank loss restriction.

### Change of control

There are various anti-avoidance rules aimed at preventing 'loss buying' and 'loss refreshing'. In particular, the carry-forward of trading losses may be denied if there is:

- a major change in the nature or conduct of a trade carried on by the loss-making company within three years before, or up to five years after, the change in ownership; or
- a change in ownership of a company at any time after the scale of its trading activities has become small or negligible but before any considerable revival of the trade.

The insertion of a new holding company at the top of a group of companies does not of itself constitute a change in ownership for these purposes.

Similarly, there are restrictions on the carry-forward of non-trading losses following a change of ownership where there is:

- a major change in the nature or conduct of the trade or business of the loss-making company within three years before, or up to five years after the change in ownership;
- a significant revival of a trade or business that has become small or negligible; or
- a significant increase in the capital of the business.

The post-change of ownership five-year period only applies where both the change to the trade or business and the change in ownership take place on or after 1 April 2017. Where this is not the case, the carry-forward of trading losses may only be denied where the change to the trade or business occurs up to three years after the change in ownership.

To the extent that losses are not already dealt with by the loss-buying rules explained above, under the proposed new rules where the change of control occurs on or after 1 April 2017, carried forward losses cannot be used against profits that arise within five years of the change of ownership and which can be attributed to a major change within the required period (five years for a trade or eight years for an investment business) in the nature or conduct of the company's business or of a co-transferred company's business. A co-transferred company is any company that was related to the transferred company both immediately before and immediately after the change in ownership.

Although the new rules permit group relief surrenders of carried forward losses, where there is a post-1 April 2017 change in ownership of a company, the new group cannot be able to claim group relief for any of the acquired company's pre-acquisition losses in the following five years.

There are also a range of restrictions on the use of capital losses.

## 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

In principle, a UK resident acquisition company benefits from relief from UK corporation tax for borrowings incurred to acquire the target, but this is an area that is subject to continually increasing restrictions:

- the UK has a thin capitalisation regime that applies to domestic as well as cross-border transactions – if the lender is a related party or the borrowing is guaranteed by a related party, these rules will be applied to determine the amount that the borrower could have borrowed from an independent lender and this can result in part of the borrowing costs being non-deductible;
- a newly introduced EBITDA-based cap on net interest expense (see below);
- interest will not be deductible where it is treated as a distribution – this will include situations where the interest exceeds a reasonable commercial return, the rate depends upon the performance of the borrower or the loan is convertible into shares;
- interest relief may also be restricted where the loan has an unlawful purpose, namely where a main purpose of being party to the loan in the relevant accounting period is to obtain a tax advantage; and

- interest relief may be denied or reduced by a targeted anti-avoidance rule where:
  - a loan-related tax advantage arises from arrangements;
  - the obtaining of the tax advantage was a main purpose of the arrangements; and
  - the tax advantage cannot reasonably be regarded as consistent with the policies and principles of the legislation.

In line with the Organisation for Economic Co-operation and Development (OECD)'s recommendations in relation to Action 4 of the base erosion and profit shifting (BEPS) project, the UK introduced in the second Finance Act of 2017 an EBITDA-based cap on net interest expense with effect from 1 April 2017. The restrictions, which apply only where a group has over £2 million in UK net interest expense, include:

- a fixed ratio rule that limits corporation tax deductions for net interest expense to 30 per cent of a group's UK EBITDA and a group ratio rule based on the net interest to EBITDA ratio for the worldwide group; and
- a modified debt cap which provides that a group's net UK interest deductions cannot exceed the global net third party interest expense of the group (operating with 'similar effect' to the worldwide debt cap which formed part of the previous interest restriction regime).

Withholding tax on interest (at 20 per cent) may be reduced or eliminated under a relevant double tax treaty, or benefit from one of the various domestic exceptions (see question 13). In any event, there is no requirement to withhold tax from interest payable on borrowings where the loan is only capable of being outstanding for less than one year.

## 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

On an acquisition of shares, a purchaser would generally expect to receive the benefit of both a tax covenant and tax warranties. The tax warranties will seek to elicit information about the target, and potentially form the basis of a claim for breach of contract if they prove to be incorrect, subject to the purchaser being able to evidence causation and loss. The tax covenant will give pound-for-pound protection (ie, the purchaser will not have to show loss to bring a claim) in respect of historic tax liabilities of the target; this protection may be sought up to the last accounts date, a specified 'locked box' date or the date of completion, depending on the commercial agreement between the parties as to the basis on which the purchase price has been calculated and the allocation of risk. The tax covenant is often drafted as a deed but it can also be included in the share purchase agreement.

Payments under a tax covenant claim or tax warranty claim should always be made between the seller and the purchaser as an adjustment to the purchase price (rather than being made directly to the target company); the purchaser should not then be subject to UK tax on receipt (nor should there be any requirement to withhold tax from the payment). If any payment exceeds the purchase price (which is most likely to occur following the sale of a distressed company), these payments (to the extent of the excess) are likely to constitute taxable receipts for the purchaser. In this situation, the purchaser should seek to negotiate a gross-up obligation in the sale documentation.

There are fewer tax warranties given in a typical business purchase agreement because in general the tax liabilities remain with the company and do not attach to the assets.

## Post-acquisition planning

### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

The nature of any post-acquisition restructuring will be specific to each transaction; however, the objectives will often be similar. These include the desire to ensure that the newly acquired assets are fitted



into the purchaser's group in the most efficient manner, as influenced by tax and financing considerations, and that interest relief obtained in respect of any debt funding incurred to finance the acquisition can be set off against taxable profits generated by the business.

Restructuring will often involve steps such as hiving down the target or its business into existing subsidiaries, sale and leaseback arrangements with property investment subsidiaries, the sale and licensing of intellectual property or the insertion of new holding companies.

## 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

There are various corporate actions available to achieve a spin-off, including direct-dividend demergers, indirect (or 'three-cornered') demergers, capital-reduction demergers or liquidation schemes. Effecting a tax-efficient demerger involves ensuring that shareholders do not receive taxable income, rollover relief is available for shareholders in respect of any receipt of new shares, no chargeable gain is realised by the demerging company and transfer taxes are minimised.

These structures rely on different reliefs and exemptions from a shareholder perspective – direct-dividend demergers will often seek to fall within the exempt distribution legislation, whereas capital-reduction demergers will seek to ensure shareholders benefit from reorganisation treatment (and thus, effectively, a rollover of any chargeable gain).

The choice will depend upon commercial factors, as well as the distributable reserves position, whether shares or business assets are to be spun out, the residence of the companies involved and the residence and other characteristics of the shareholders of the demerging company.

Trading losses may be capable of being preserved, although the plethora of anti-avoidance rules (see question 7) will need careful consideration in this context.

While stamp duty or SDRT would be payable if the spin-off involves the transfer of shares in a UK company, in practice it is usually possible to rely on available reliefs (notably acquisition relief), or ensuring that there is no transfer for consideration (ie, by implementing a cancellation scheme rather than a transfer scheme, or relying on a distribution being for no consideration). No stamp duty or SDRT should therefore be payable. Where a spin-off involves transactions in UK land, it is likely that SDLT would need to be paid in respect of such transaction.

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

A UK-incorporated company will be resident in the UK for tax purposes regardless of whether or not its central management and control is located in the UK. The only way to migrate a UK-incorporated company such that it is no longer treated as UK-resident is to ensure that its place of effective management and control is in a jurisdiction with a suitable double tax treaty. Such a treaty would need either to contain a residence tiebreaker clause (providing that the company is treated as resident solely in its place of effective management and control) or provide for a mutual agreement procedure to determine residence (which may resolve the question in favour of the place of effective management and control, but carries with it the risk of uncertainty of outcome).

A non-UK-incorporated company will only be tax resident in the UK if it is centrally managed and controlled in the UK. Such a company can lose its UK tax residence by becoming centrally managed and controlled in another jurisdiction.

The UK imposes an exit charge on UK-resident companies (whether UK or non-UK-incorporated) that cease to be UK tax resident: the company is deemed to have disposed of and immediately reacquired all of its capital assets at their market value when it leaves the UK, thus creating a charge to corporation tax on any latent capital gains (unless a relief such as the SSE applies). Companies migrating to an EU or European Economic Area (EEA) country can seek to agree an exit charge payment plan with HMRC, which allows the resulting corporation tax to be paid in instalments or deferred for a period of up to

10 years until the relevant asset has been sold. The migrating company must notify HMRC of its proposed migration.

Under the draft Finance Bill 2019, the UK government proposed a series of changes to the exit charge regime in order to comply with ATAD. The changes, which are intended to take effect from 1 January 2020, include removing the choice to pay upon realisation, so that the exit charge will need to be paid in six equal annual instalments, resulting in a maximum deferral of five years.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

### Interest

The UK imposes withholding tax at the rate of 20 per cent on 'yearly interest', namely interest paid on loans capable of being outstanding for one year or more. This rate may be reduced by an applicable double tax treaty, and can currently be eliminated where the Interest and Royalties Directive applies.

In addition, there are various domestic exceptions that may be available. There is no obligation to withhold if:

- the interest is paid by a bank in the ordinary course of its business;
- the person beneficially entitled to the interest is a UK-resident company, or is non-UK resident but carries on a trade in the UK through a permanent establishment and is subject to UK tax on the interest;
- the interest is paid on a quoted Eurobond, namely an interest-bearing security issued by a company listed on a recognised stock exchange;
- the interest is paid on debt traded on a multilateral trading facility operated by a recognised stock exchange in an EEA territory; or
- the interest is paid on qualifying private placements.

There is no obligation to withhold tax on 'short interest' (broadly where the loan will be outstanding for less than one year) or on returns that constitute discount (rather than interest).

### Dividends

The UK does not generally impose a withholding tax on dividends. However, 'property income dividends' paid by UK real estate investment trusts are subject to withholding tax at a rate of 20 per cent if paid to non-resident shareholders (or to certain categories of UK-resident shareholders), although this may be reduced by an applicable double tax treaty.

### Royalties

Until recently, withholding tax (at 20 per cent) was only due on a narrow range of royalties, notably certain annual payments and royalties in respect of patent rights, copyright or a right in a design. Double tax treaties can then apply to exempt royalties from withholding, or reduce the applicable rate.

However, since 28 June 2016 withholding tax is applied to any royalty paid in respect of intangible assets. The scope and significance of this withholding tax on royalties has been extended by two related changes:

- royalties connected with a permanent establishment (PE) or, in diverted profits tax terms, an avoided PE, that a non-UK resident has in the UK will be treated as having a UK source; and
- a treaty override will apply if a royalty payment is made to a connected person as part of arrangements a main purpose of which is to obtain a tax advantage by virtue of a double tax treaty, such that the withholding tax will be required irrespective of whether the treaty would otherwise restrict the UK's taxing rights.

In the Autumn Budget 2017, the UK government launched a consultation regarding the possibility of extending withholding tax on royalties to cover non-UK entities that make sales to UK customers. This would in practice affect digital multinational companies who have located their IP in low-tax jurisdictions that do not have tax treaties with the UK.

## Update and trends

### Digital tax

Like other countries, the UK has been taking increasing interest in the taxation of the 'digital economy'. The traditional idea that profits should be taxed in the countries where businesses create value is arguably outdated in a world where many businesses earn profits in countries where they have little or no physical presence. Value might be created when a user shares a video or completes a survey rather than ordering a product.

In the 2018 Spring Statement, the UK government published an updated position paper. As an interim measure, the paper recommended a new tax on the revenues of digital businesses deriving significant value from UK user participation, irrespective of where those businesses are located and whether they have a physical presence in the UK. In the long term, the government has advocated for wider reform to global tax rules in order to take user-created value into account when determining how the taxable profits of digital businesses are allocated between countries.

At the same time, the European Commission and the OECD have developed their own proposals regarding digital tax, with the Commission proposing an interim digital services tax, potentially set at 3 per cent of revenues created from activities where users are key to value creation. This would in time transition to a system taxing the profits of platforms with a 'significant digital presence', measured by reference to user base or revenue from digital services. The OECD has proposed a global review of profit allocation and nexus rules, and will consider the extent to which digital businesses should be treated differently. Failure to agree principles on a multilateral level could result in an uncertain environment for businesses over the coming years.

### Brexit

With the UK's exit from the EU on 29 March 2019 drawing closer, there is still very little clarity regarding the nature of the UK's future relationship with the EU. The confirmation in March 2018 that a post-Brexit transitional period would apply until 31 December 2020 provided business with some reassurance by allowing for more time to finalise a UK-EU trade deal.

The UK government made a proposal in July 2018 involving ongoing harmonisation of rules regarding goods and a 'facilitated customs arrangement', where the UK would set its own tariffs but also collect tariffs on the EU's behalf with respect to goods bound for the continent. This proposal has proven controversial both in Brussels and in the UK, meaning that business should remain alert to the possibility of a 'no-deal' Brexit.

### Non-residents and real estate

A series of reforms announced in the Autumn Budget 2017 and included in the draft Finance Bill 2019 have a significant effect on non-UK residents with interests in UK real estate.

With effect from 6 April 2019, when non-UK residents realise gains on the disposal of interests in UK property, those gains will fall within the charge to corporation tax (for non-resident companies) or capital gains tax (for other non-resident persons). This measure extends the scope of the current charge on residential property to cover non-residential property, along with property (of either type) held by closely held companies, widely marketed schemes and life assurance companies. Non-residents should also be aware that gains on the disposal of indirect interests of UK property may also be subject to tax, for instance when selling shares (representing an interest of at least 25 per cent) in a 'property rich entity' – an entity deriving at least 75 per cent of its value from UK land.

In addition, the UK property income of non-UK resident companies will fall within the scope of corporation tax rather than income tax with effect from 6 April 2020. Many such companies will need to complete and file corporation tax returns for the first time, and will need to bear in mind general corporation tax principles – for instance, profits arising from loan relationships and derivative contracts will fall within the charge to tax to the extent that they relate to UK property business.

The overall effect of these reforms will increase the compliance burden – and in many cases the tax liability – for non-UK investors investing in UK real estate.

## 14 Tax-efficient extraction of profits

### What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Profits may be extracted from a UK company either by way of declaring dividends or by interest payments on loans made to the company by its shareholders. Dividends are not deductible for corporation tax purposes. Interest payments are, however, deductible for the borrower (even where loans are advanced by a shareholder), subject to the restrictions outlined in question 8.

## Disposals (from the seller's perspective)

### 15 Disposals

#### How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

While this will depend on the particular facts, sellers typically prefer to sell shares in the target where the disposal would be expected to result in a gain. The SSE will exempt any chargeable gain from corporation tax where the relevant conditions are satisfied. There are three exemptions within the SSE, the main one applying where:

- the seller holds a 'substantial shareholding' in the target (broadly 10 per cent);
- the target is a sole trading company or a member of a trading group; and
- the seller has held the substantial shareholding for a continuous 12-month period beginning not more than two years before the date on which the disposal takes place.

The availability of the SSE is not restricted to the disposal of shares in UK companies; the conditions are equally capable of applying to disposals of shares in foreign holding companies.

If the disposal would result in an economic loss for the seller and the conditions for the SSE would apply to the sale of shares, no capital

loss will be crystallised by the disposal of such shares. The seller may consider disposing of the business assets in this scenario.

### 16 Disposals of stock

#### Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?

Gains arising from the disposal of shares in a UK company by a non-resident are generally not subject to UK corporation tax, subject to certain anti-avoidance rules.

There are anti-avoidance rules applying to the disposal of shares in a company that owns UK real estate. Where a non-resident acquires UK real estate through a UK company, such that the main purpose of the acquisition is to realise a gain, an income tax charge may arise in respect of gains made on the disposal of shares in the UK company holding the real estate.

Following a consultation announced in Autumn Budget 2017, the draft Finance Bill 2019 legislation includes a series of proposed reforms that bring gains made by non-UK residents on the direct or indirect disposal of interests in UK immovable property into the charge to corporation tax (for non-resident companies) or capital gains tax (for other non-resident persons). The new regime will, subject to limited exceptions, tax gains arising from disposals of shares in entities which derive at least 75 per cent of their value from UK land and where the person making the disposal holds a substantial indirect interest in the land (generally at least 25 per cent). The reforms will take effect from 6 April 2019.

Separately, special rules apply to disposals by non-residents of shares in companies that hold petroleum production licences for the exploration or exploitation of oil and gas in the UK or the UK's continental shelf.

**17 Avoiding and deferring tax****If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

Where a UK company is disposing of shares and would otherwise realise a chargeable gain on such disposal (ie, the conditions for the SSE to apply are not satisfied), the seller may still be able to defer payment of any tax liability if the consideration for the sale comprises shares or loan notes:

- if the consideration comprises qualifying corporate bonds (QCBs) in the purchaser (broadly, securities expressed and redeemable in sterling), the chargeable gain will be held over until the QCBs are redeemed or sold; and
- if the consideration consists of shares issued by the purchaser or securities that do not constitute QCBs, any gain will be rolled over into those shares or non-QCBs and will be triggered when such shares or securities are sold or redeemed.

Where a UK company disposes of business assets, tax on any chargeable gains arising from the sale of land, buildings and fixed plant and machinery can be deferred by claiming business asset rollover relief, provided the proceeds of the sale are reinvested in qualifying assets. The gain is effectively rolled over into the new asset and becomes payable when the replacement asset is sold (unless a further claim for rollover relief is made at that time) or, if the new asset is a depreciating asset, on the earlier of the disposal of that asset and 10 years following its acquisition.

A similar rollover regime applies to the disposal of intangible assets.

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# United States

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## Acquisitions (from the buyer's perspective)

### 1 Tax treatment of different acquisitions

**What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?**

#### Taxable acquisitions

##### *Stock acquisitions*

All assets and liabilities of the target as they exist immediately prior to the closing are assumed in the transaction. The acquirer receives a basis in the target stock acquired equal to purchase price. Absent a section 338(h)(10) election as described below, there is no step-up in the basis of the target's underlying assets and, consequently, no opportunity to utilise the purchase price paid to generate higher depreciation deductions on the target's assets. In general, sellers prefer stock sales due to possible taxation at lower capital gains rates (generally 20 per cent) and the ability to divest all of the target's liabilities. The acquirer receives the benefit of the target's historic tax attributes (eg, net operating losses (NOLs)) as they remain with the target following the acquisition.

##### *Asset acquisitions*

An asset acquisition provides the buyer with flexibility to choose which target assets to acquire and which target liabilities to assume. However, asset acquisitions generally present the seller with less opportunities to avail themselves of the lower 20 per cent US federal income tax rate on capital gains. However, a corporate seller of assets will be taxed at a rate of 21 per cent, which is marginally higher than the capital gains rate, subject to a second layer of income taxation when the sale proceeds are distributed via dividend to the target's shareholders. In an asset acquisition, the acquirer receives basis adjustments in the acquired assets, with the purchase price allocated among the assets (generally in a manner agreed upon by the acquirer and seller). Typically, acquirers prefer asset acquisitions owing to the ability to receive a step-up in basis in the target's assets (which is discussed in question 2), resulting in higher post-acquisition depreciation deductions. In general, the acquirer will not benefit from the target's tax attributes as they remain with the target after closing.

##### *338(h)(10) election option*

A section 338(h)(10) election is used where the transaction must be structured as a stock acquisition for legal purposes, but the acquirer desires a basis step-up in the target's assets so that it can receive higher post-acquisition depreciation deductions. If the parties can comply with its numerous requirements, upon making a 338(h)(10) election, old target generally is deemed to have sold all of its assets to new target, followed by a deemed liquidating distribution of the proceeds by old target to its shareholders immediately before the acquisition date. A section 338(h)(10) election can disadvantage the seller when the basis it has in the target's assets is lower than its basis in its target company stock (which is often the case). In these situations, the acquirer and seller often negotiate over additional consideration to be paid to the seller to offset some or all of the additional US federal income tax liability owed by the seller as a result of the election.

## Acquisitions via tax-free reorganisation

Corporate acquisitions in the US can be accomplished via tax-free reorganisation, provided that the strict conditions to qualify under the Internal Revenue Code (the Code) are met. Tax-free reorganisations come in many forms under US tax law, but in general such reorganisations are tax-free only to the extent that stock is exchanged as consideration. Therefore, they are appropriate where the acquirer's stock will form a significant portion of the consideration tendered in the transaction. Where cash or other property (but not stock) (boot) is received in what would otherwise be a tax-free reorganisation, the boot generally is subject to US federal income tax in an amount equal to the lesser of the seller's gain or the amount of the boot received by the seller. Although these transactions are commonly referred to as 'tax-free', note that the tax that would otherwise be due upon receipt of acquirer stock is deferred rather than avoided altogether.

The types of transactions that can qualify as tax-free reorganisations for US federal income tax purposes include:

- statutory mergers under state law – target shareholders exchange their shares for acquirer stock;
- forward triangular mergers – the target corporation is merged into a subsidiary of the acquiring corporation, with the subsidiary constituting the surviving entity;
- reverse triangular mergers – a subsidiary of the acquirer is merged into the target corporation, with the target constituting the surviving entity;
- 'B' reorganisations – the acquirer exchanges its voting common or qualified preferred stock for ownership of at least 80 per cent of the 'vote and value' of the target corporation's stock. The target corporation survives as a subsidiary of the acquirer; and
- 'C' reorganisations – the acquirer exchanges its voting common or preferred stock for 'substantially all' of the target's assets. Following this exchange, the target is liquidated and transfers its assets (constituting acquirer shares and any assets not transferred to the acquirer) to its shareholders.

Qualification of a particular transaction under one of the tax-free reorganisation provisions of the Code hinges on factors such as continuity of interest (ie, a sufficient number of target shareholders are shareholders of the surviving entity following the transaction) and continuity of business enterprise (ie, continuation of the target's historic business or use of a significant portion of the target's assets following the closing), along with limitations on the levels of boot.

Note that using a non-US acquisition vehicle in the context of a tax-free reorganisation can nullify tax-free treatment as described under questions 3 and 4. Therefore, non-US acquirers that wish to avail themselves of the tax-free reorganisation provisions should form a US subsidiary to effectuate the transaction.



## 2 Step-up in basis

**In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?**

An acquirer receives a step-up in basis of the target's assets in a taxable asset purchase.

When a transaction is structured as a purchase of equity in a target classified as a 'partnership' or 'corporation' for US federal income tax purposes, the acquirer may receive a step-up in basis in the business assets of the target only if certain elections pursuant to the Code are timely made (or are currently in effect). If the target is classified as a 'partnership,' a section 754 election must be (or already have been) timely made. If the target is classified as a 'corporation,' a section 338(h)(10) election must be timely made (as described in question 1).

Where acquirer receives a step-up in basis of the target's assets because the transaction is structured as a taxable asset purchase or an acquisition of equity in a 'partnership' or 'corporation' (in the case of such an equity purchase, assuming for this purpose that the elections described above have or will be made), the parties generally agree via contract upon the allocation of the transaction consideration among the acquired assets. In this regard, the target (or its owners) typically desires to allocate consideration to assets that qualify for capital gains treatment (taxable at a 20 per cent rate). On the other hand, the acquirer typically desires to allocate consideration to assets that will generate higher post-acquisition depreciation deductions.

Acquirer may be able to amortise (depreciate) goodwill and other intangibles over a 15-year period. Intangibles – and specifically goodwill – are areas in an asset acquisition (or deemed asset acquisition) where acquirer and seller could have aligned interests due to the likely availability of favourable capital gains rates for seller and the benefit that the acquirer may receive post-closing benefits related to the amortisation deductions on such intangibles.

## 3 Domicile of acquisition company

**Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?**

If the acquisition company is acquiring the stock of a US corporate target, the acquisition company can be either a US or a non-US company.

If the acquisition vehicle is merging into a US corporate target, it is generally preferable that the surviving entity be a US corporate entity. Exceptions may include where the non-US acquirer anticipates incurring losses or will distribute profits out of the US branch on a current basis. The rationale supporting the preference for a US acquisition company includes the fact that use of a non-US company subjects the acquirer to possible exposure to US federal 'branch profits tax'. The branch profits tax is a 30 per cent gross basis tax (subject to treaty reductions) imposed on the 'dividend equivalent amount' of the US branch of a non-US corporation. The branch profits tax regime effectively imposes the tax on deemed withdrawals from the US branch. The purpose of the branch profits tax is to tax US branches of a non-US corporation in a similar manner to US corporations with non-US parent corporations conducting the same activities. The 30 per cent rate mirrors the US federal withholding tax rate imposed on US corporations making dividend payments to their non-US parents.

Absent the branch profits tax, US branches of foreign corporations would only pay federal income tax once at the corporate level (at a 21 per cent rate) without taxing dividends made by the non-US corporation to its shareholders. Instead, if the non-US acquirer forms a US corporate subsidiary as the acquisition vehicle, the acquirer avoids imposition of the branch profits tax and only triggers US federal income tax on dividends upon actual payment of those dividends to the non-US parent (thus controlling the timing of the imposition of US tax on dividends) – such tax being in the form of a withholding tax at a 30 per cent rate (which may be reduced via an applicable income tax treaty).

Second, use of a non-US corporate acquirer with other activities outside of the US introduces complex issues of apportioning interest expenses to the US effectively connected income of the non-US acquisition company. Using a US acquisition vehicle can provide opportunities

to use leverage to generate deductions against the US taxable income of the US business activities in question.

Third, a US corporate acquirer may be better positioned to claim US federal income tax deductions for acquisition related expenses (as opposed to claiming such expenses as deductions in a non-US acquirer's home jurisdiction).

Finally, use of a foreign acquisition vehicle in a tax-free reorganisation or tax-free exchange transaction could nonetheless trigger gain recognition under section 367 (as further discussed in question 4).

## 4 Company mergers and share exchanges

**Are company mergers or share exchanges common forms of acquisition?**

Company mergers and share exchanges are common when the target's owners desire to hold acquirer equity after the deal is consummated (whether in the context of a tax-free reorganisation or for other business considerations) or when the acquirer's stock will be publicly traded following the closing and target's owners have optionality as to whether to hold or sell such stock.

Where the target company's owners will receive acquirer stock as the principal consideration in a transaction, such owners likely will be motivated to qualify the transaction as a tax-free reorganisation. There are a number of possibilities under US federal tax law to structure a transaction as a 'tax-free reorganisation,' the most common of which are discussed in question 1. However, where the acquirer is a non-US corporation, section 367 of the Code severely restricts the ability of a US owner of a target company to engage in a tax-free reorganisation. As such, non-US acquirers needing to effectuate a tax-free reorganisation generally should pursue the transaction via a US subsidiary.

One notable downside to tax-free reorganisations are that the acquirer will not receive a step-up in basis of the target company's assets, thus stripping the acquirer of any ability to avail itself of higher post-closing depreciation deductions.

## 5 Tax benefits in issuing stock

**Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?**

If acquirer stock will form a substantial portion of the consideration tendered in the transaction, there is potential to utilise the tax-free reorganisation provisions of US tax law to acquire the target on a tax-free basis. A discussion of the tax-free reorganisation provisions in this context can be found at questions 1 and 3.

## 6 Transaction taxes

**Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?**

Regardless of how an acquisition is structured, US federal tax law imposes no transaction taxes. However, certain US states and municipalities impose transaction taxes, the types and applicable rates of which vary depending on the US jurisdiction in question. Most often, these transaction taxes are imposed on the target or its owners upon consummation of the sale. State and municipal transaction taxes imposed in any transaction could include sales and use, registration, stamp and recording taxes. The seller and acquirer in any transaction subject to transaction-based taxes usually negotiate the party ultimately responsible to bear the cost of such taxes.

## 7 Net operating losses, other tax attributes and insolvency proceedings

**Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?**

### Limitations on net operating losses

The US federal income tax code imposes substantial limitations on the ability to utilise NOLs, tax credits and other deferred tax assets of the

target corporation. The recently enacted Tax Cuts and Jobs Act of 2017 (the Act) drastically changed the rules related to the carryforward and carryback of NOLs. Prior to the Act, NOLs were generally eligible for two-year carryback and 20-year carryforward periods. Further, NOL carryovers and carrybacks could fully offset taxable income of the taxpayer (subject to other limitations under US tax law, such as section 382 limitations described below). Under the Act, the carryback of NOLs is now prohibited, but NOLs may now be indefinitely carried forward. These new carryback and carryover rules apply to any NOL arising in a taxable year ending after 31 December 2017. As a result, a target's NOLs acquired in a transaction must be tracked separately to ensure that the correct rules are applied.

The Act also imposed new limitations on the amount of NOLs that a corporation may deduct in a single tax year. This limitation is equal to the lesser of the available NOL carryover or 80 per cent of a taxpayer's pre-NOL deduction taxable income. This new NOL limitation applies only to losses arising in tax years that begin after 31 December 2017. Consequently, US targets with historic NOLs may avail themselves of the old rules in respect of such NOLs.

Layered on top of the general NOL rules, upon an 'ownership change', section 382 limits the amount of NOLs that can be used to offset post-acquisition taxable income: this limit is called the '382 Limitation'. An 'ownership change' occurs if 5 per cent or more shareholders, as a result of a triggering event (stock acquisitions and most reorganisations), increase their ownership in the loss corporation by more than 50 percentage points.

The 382 Limitation equals the product of (a) the loss corporation's value at the time of the ownership change, and (b) a designated rate of return (called the 'long-term exempt rate'). For purposes of (a), the value of the loss corporation is measured as the fair market value of all of its stock (generally immediately before the ownership change), subject to 'anti-stuffing' rules that ignore certain pre-ownership change asset additions and certain non-business assets in calculating fair market value. The long-term exempt rate is determined monthly and published by the IRS. By way of example, the long-term exempt rate for ownership changes occurring in July 2018 was 2.32 per cent. Any unused 382 Limitation can be carried over to subsequent tax years.

Section 382 also imposes a continuity of business requirement that generally must be met for two years following the ownership change. In a reorganisation context, the new loss corporation must continue the historic business of the old loss corporation or otherwise use a significant portion of the old loss corporation's assets in the new loss corporation's business throughout such two-year period.

#### Other limitations on tax attributes

Section 383 operates to limit the use of tax credit carryovers using the annual limitation principles of section 382.

#### Application of rules to bankrupt or insolvent entities

The NOL and tax credit limitation rules discussed above also apply to corporate targets emerging from bankruptcy or acquisitions of insolvent targets.

### 8 Interest relief

**Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?**

Whether an acquisition company will receive interest relief related to borrowings utilised to acquire the target company (viz, deductions for interest paid) depends on whether the acquisition vehicle is a non-US company or a US company.

If the acquisition company is a non-US company, interest relief generally becomes an issue of non-US taxation. However, to the extent the target company is a pass-through post-acquisition (eg, a 'partnership') and the non-US company is engaged in US business, it is feasible to allocate a portion of the non-US companies' worldwide interest expense as a deduction against US business income.

If the acquisition company is a US corporate subsidiary of the non-US corporate parent, then such subsidiary may be able to obtain

interest relief for borrowings used to acquire the target company – or from debt pushed down by the non-US corporate parent – subject to certain limitations. For instance, as a result of the Act, interest expense deductions may be limited to 30 per cent of the subsidiary's adjusted taxable income; however, this limitation only applies to taxpayers with average annual gross receipts for the three preceding taxable years in excess of \$25 million. Other limitations exist where the debt is owed to a related party, which may be the case where the US corporate subsidiary borrows money from its non-US corporate parent to acquire the target. In those circumstances, if the US corporate subsidiary is on the accrual method of accounting (which is typical for corporations), then the interest payments may not be deducted until paid. Moreover, any loan between the US corporate subsidiary and non-US corporate parent must be carefully scrutinised to ensure that the arrangement results in a true debtor-creditor relationship. Otherwise, the debt could be recast as equity, and deductions for interest paid thereon would be denied.

In respect of withholding taxes, interest paid to a non-US corporate parent (or unrelated non-US company) by a US subsidiary company will generally be subject to withholding tax at a rate of 30 per cent, subject to possible reduction under an applicable income tax treaty.

### 9 Protections for acquisitions

**What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?**

#### Protections for stock and business asset acquisitions

It is customary for acquirers of both stock and business assets to receive representations and warranties related to the business being acquired, including representations and warranties related to the taxation of the pre-acquisition business. The representations and warranties related to a stock acquisition are often more comprehensive than those in a business asset acquisition due to the fact that a stock acquisition results in the acquirer effectively stepping into all pre-acquisition liabilities (including assuming the risks related to pre-acquisition taxation), while the liabilities to be assumed in a business asset acquisition generally can be negotiated by the parties. Indemnification covenants granted by the sellers, sometimes secured via a post-closing escrow, typically are used to protect the acquirer from any breach of seller representations and warranties. Such indemnification covenants are often carefully negotiated to include caps and other limitations on seller liability, with such limitations varying depending on the nature of the representations and warranties in question. These protections are usually documented in a comprehensive purchase or merger agreement, with other possible ancillary agreements (eg, escrow agreements).

#### Taxation of indemnity payments

An indemnity payment from seller to the acquirer is normally treated as an adjustment to purchase price and, therefore, does not trigger withholding tax. Instead, the acquirer's basis in the assets acquired (whether stock or assets) would be reduced to reflect the purchase price reduction. The seller, however, would adjust the amount of gain subject to US federal income tax reported as a result of the acquisition.

### Post-acquisition planning

#### 10 Restructuring

**What post-acquisition restructuring, if any, is typically carried out and why?**

Post-acquisition restructuring is common and occurs for a myriad of reasons. For example, if the US target holds interests in subsidiaries that operate in non-US jurisdictions, it is common to restructure such operations such that the non-US business operations are separated from the US target. In this manner, profits from non-US operations can be free of US tax consequences, and earnings may be injected into the non-US business operations (whether through debt or equity investment) without US federal tax exposure. In addition, post-acquisition restructuring often is necessary to align or consolidate business lines and to eliminate redundancies. In many instances, post-acquisition restructuring can be accomplished via tax-free reorganisations, consolidations or spin-offs (as described in question 11).

## 11 Spin-offs

**Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?**

Yes, following the acquisition of the target business, tax-neutral spin-offs are often used to separate lines of businesses held in subsidiary corporations. A tax-neutral spin-off cannot occur until the five-year anniversary of the US target's acquisition.

For US federal income tax purposes, a properly structured spin-off will result in no taxable gain to the recipient shareholders, no corporate level taxable gain, and carryover basis in the stock received in the spun-off subsidiary (generally representing the shareholder's basis in the parent corporation, apportioned between the parent corporation and spun-off corporation based on their relative fair market values).

To qualify as a tax neutral spin-off, the following requirements must be met:

- **Control.** The parent must control (generally ownership of 80 per cent of the total voting power and 80 per cent of each class of non-voting stock) the spun-off subsidiary immediately before the spin-off. In certain circumstances, the parent or its shareholders must also control the spun-off subsidiary immediately after the spin-off.
- **Device to Distribute Earnings.** The spin-off cannot principally be a device to distributing earnings and profits of parent, spun-off subsidiary or both.
- **Active Trade or Business.** In general, both parent and the spun-off corporation must be engaged in an active trade or business and that trade or business must have been continuously conducted throughout the five-year period ending on the date of the spin-off.
- **Complete Distribution.** In general, the parent must distribute all of the stock it owns prior to the spin-off in the subsidiary. The distribution must be made to the parent's shareholders in respect to their parent stock or in exchange for the parent's securities.
- **Business Purpose.** There must be a valid business purpose (other than tax) supporting the spin-off.
- **Continuity of Interest and Business Enterprise.** There are detailed rules that impose continuity and business of ownership requirements.

In general, tax attributes of the spun-off subsidiary are preserved, including NOLs, subject to whether there was an 'ownership change' that triggers the section 382 rules described in question 7.

There would be no US federal transfer taxes imposed on a spin-off, but state and local transfer taxes may apply (as discussed in question 6).

## 12 Migration of residence

**Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?**

It is difficult to migrate the residence of a US acquisition or target company without triggering US federal income tax. In the case of a non-US corporate acquirer, migrating the residence of such acquirer to another non-US jurisdiction without triggering US federal income tax is largely dependent on whether the US acquirer holds US real property interests. If the non-US acquirer holds US real property interests, then migration may occur without the incidence of US federal income tax so long as the migration takes a certain transactional form and various US income tax filing obligations are met.

Migrating a US target – whether the target is a 'corporation' or 'partnership' – can be very difficult to accomplish on a tax-neutral basis. For example, section 367 can impose an 'exit-tax' on any built-in gain (but not built-in loss) inherent in a migrating US corporate target's assets. Additionally, to the extent such US corporation's assets consists of intangible property, a deemed royalty stream may be subject to taxation under section 367 of the Code. Similar US tax consequences arise when a US corporate target is liquidated into its non-US corporate acquirer, unless the non-US corporate acquirer meets several conditions, one of which is to use the assets distributed from the US corporation in a US business for 10 years following such liquidation.

Another complicated tax regime can apply where a non-US corporate acquirer purchases substantially all of the property of the US

## Update and trends

The most notable hot topic in the law of tax on inbound investment in the United States is the enactment of the Tax Cuts and Job Act of 2017 (the Act) late last year. The Act made sweeping changes to the US federal tax code, many of which significantly impacted both new and existing inbound investment structures. The important changes affecting inbound US investment included:

- reduction of the federal income tax rate on corporations from 35 per cent to 21 per cent;
- substantial changes to the net operating loss deduction and carryforward rules;
- new limitations on interest expense deductions; and
- implementation of a new Base Erosion and Anti-Abuse Tax, the purpose of which is to disincentivise large corporate taxpayers from eroding the US tax base via certain deductible payments made to related non-US parties.

The Act's significant reduction of the US federal corporate income tax rate has resulted in a new focus on the use of corporations for inbound investment. Where a US corporate subsidiary can be paired with a non-US corporate parent, benefits may include: (i) limited US income tax filing exposure; and (ii) for natural persons owning beneficial interests in the US corporate subsidiary, US estate tax protection. Moreover, depending on what assets are held by the US corporate subsidiary, the non-US corporate parent, company or individual may not be subject to US federal income tax on disposal of the shares in such subsidiary.

target, and the US target's owners have a threshold equity interest in the non-US corporate acquirer post-closing. Section 7874 (setting forth the 'anti-inversion' tax regime) imposes US federal income taxation as if the non-US acquiring corporation were a US corporation. The policy behind section 7874 is to discourage US companies from migrating to non-US jurisdictions. The anti-inversion regime can be extremely complex and any transaction that could become subject to its underlying rules warrants careful scrutiny.

## 13 Interest and dividend payments

**Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?**

In general, US federal tax law imposes a 30 per cent withholding tax on US-source interest and dividends paid to non-US payees, subject to reduction via an applicable income tax treaty. Important exceptions to withholding on interest include debt obligations that qualify under the 'portfolio interest' rules, bank deposit interest and obligations that mature within 183 days or less. If the obligor is a corporation, to qualify as portfolio interest, the debt instrument must be in registered or bearer form, the interest must be paid to a shareholder owning less than 10 per cent of the obligor's voting stock, the interest cannot be contingent (eg, contingent on the profits of the obligor), and the non-US lender must provide the obligor an applicable Form W-8 certifying that the lender is not a US person.

## 14 Tax-efficient extraction of profits

**What other tax-efficient means are adopted for extracting profits from your jurisdiction?**

Aside from dividends and interest as discussed in question 13, royalties and compensation for services performed by a non-US corporate acquirer may present opportunities for tax-efficient extraction of profits. Compensation for services performed outside the US by employees, officers or directors of the non-US corporate acquirer are not generally subject to US federal income tax. Royalties, to the extent subject to US federal income tax, may qualify for reduced US withholding taxes pursuant to an applicable income tax treaty. As part of post-acquisition integration planning, the acquirer should review the US target's dealings outside the United States in light of US tax treaty benefits that may be available for intellectual property, debt and other assets.

**Disposals (from the seller's perspective)****15 Disposals**

**How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?**

As discussed in the context of question 1 above, sellers usually desire stock dispositions, while acquirers generally favour asset dispositions. Both types of transactions are extremely common in the US. It is relatively uncommon that a US business would be sold via disposition of the sale of the business' non-US corporate parent, absent a larger global transaction that contemplates the sale of both US and non-US business operations.

**16 Disposals of stock**

**Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?**

Typically, the sale by a non-US parent of its shares of a US corporate subsidiary will not be subject to US federal income tax. However, if that US subsidiary owns US real property interests, then the gains on the sale of stock could be subject to US federal income tax. As US subsidiaries in the energy and natural resource industries often own substantial interests in US real property, any proposed disposal of stock in any such subsidiary should be closely reviewed as to its US federal income tax treatment.

**17 Avoiding and deferring tax**

**If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?**

See questions 1, 3 and 11 for a discussion of various tax-free reorganisation techniques available under US federal tax law.

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## *Getting the Deal Through*

Acquisition Finance	Enforcement of Foreign Judgments	Pharmaceutical Antitrust
Advertising & Marketing	Environment & Climate Regulation	Ports & Terminals
Agribusiness	Equity Derivatives	Private Antitrust Litigation
Air Transport	Executive Compensation & Employee Benefits	Private Banking & Wealth Management
Anti-Corruption Regulation	Financial Services Compliance	Private Client
Anti-Money Laundering	Financial Services Litigation	Private Equity
Appeals	Fintech	Private M&A
Arbitration	Foreign Investment Review	Product Liability
Art Law	Franchise	Product Recall
Asset Recovery	Fund Management	Project Finance
Automotive	Gaming	Public M&A
Aviation Finance & Leasing	Gas Regulation	Public-Private Partnerships
Aviation Liability	Government Investigations	Public Procurement
Banking Regulation	Government Relations	Real Estate
Cartel Regulation	Healthcare Enforcement & Litigation	Real Estate M&A
Class Actions	High-Yield Debt	Renewable Energy
Cloud Computing	Initial Public Offerings	Restructuring & Insolvency
Commercial Contracts	Insurance & Reinsurance	Right of Publicity
Competition Compliance	Insurance Litigation	Risk & Compliance Management
Complex Commercial Litigation	Intellectual Property & Antitrust	Securities Finance
Construction	Investment Treaty Arbitration	Securities Litigation
Copyright	Islamic Finance & Markets	Shareholder Activism & Engagement
Corporate Governance	Joint Ventures	Ship Finance
Corporate Immigration	Labour & Employment	Shipbuilding
Corporate Reorganisations	Legal Privilege & Professional Secrecy	Shipping
Cybersecurity	Licensing	Sovereign Immunity
Data Protection & Privacy	Life Sciences	State Aid
Debt Capital Markets	Loans & Secured Financing	Structured Finance & Securitisation
Dispute Resolution	Mediation	Tax Controversy
Distribution & Agency	Merger Control	Tax on Inbound Investment
Domains & Domain Names	Mining	Telecoms & Media
Dominance	Oil Regulation	Trade & Customs
e-Commerce	Outsourcing	Trademarks
Electricity Regulation	Patents	Transfer Pricing
Energy Disputes	Pensions & Retirement Plans	Vertical Agreements

*Also available digitally*

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