

## Corporate Finance/M&A - Cyprus

### M&A regime crucial to Cyprus's attempts to re-enter financial markets

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### Introduction

In the face of the many challenges ensuing from the recent economic crisis, Cyprus is struggling to regain its economic status quo and its reputation as a leading international business centre often used as the desired vehicle in international tax structures. The country's M&A regime has played a crucial role in its attempts to re-enter the financial markets.

Attempts to promote the country's competitive regime have been hampered by macroeconomic uncertainty and the magnitude of depression that resulted from its bail-out programme. Mergers and acquisitions are still two of the most important components of the development engine in terms of growth and value – even the key short-term risks cannot outweigh the advantages that foreign investors would enjoy by electing to conduct their business in Cyprus.

The M&A regime has developed rapidly in the past decade, mainly as a consequence of the 2004 accession of Cyprus to the European market as an official integrated member of the European Union. Since then, various mechanisms have been developed in order to facilitate the country's harmonisation with the *acquis communautaire* (the EU body of law).

### Legal framework

A key stepping stone in the shaping of the M&A regime was Cyprus's implementation of the EU Cross-Border Mergers Directive (2005/56/EC). The directive was arguably the preliminary legislative step for facilitating a cross-border merger between corporate entities registered in Cyprus and respective entities incorporated in any other EU member state. The legislative framework that governs the M&A regime in Cyprus includes, among other things:

- the Public Takeover Bids Law (41(I)/2007), which ratifies the EU Takeovers Directive (2004/25/EC);
- the Securities and Stock Exchange Law 1995;
- the Regulations on Cyprus Securities and Stock Exchange (Public Offer for the Acquisition of Securities and Merger of Companies Listed on the Stock Exchange) 1997;
- The Companies Act (Cap 113, Sections 198 to 201):
  - Sections 198 to 201 regulate mergers, restructuring, transfer of assets and shares and divisions (or partial divisions) of corporate entities;
  - Sections 201(A) to (H) and 201 (I) to (X) were introduced in an attempt to overhaul the mergers regime and bring it into compliance with European practices. These sections adopt, among other things, the following EU directives:
    - the EU Merger Directive (78/855/EEC) concerning mergers of public limited liability companies;
    - the EU Second Company Law Directive (77/91/EEC), in respect of the formation of public limited liability companies and the maintenance and

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- alteration of their capital; and
- the EU Sixth Company Law Directive (82/891/EEC), concerning the division of public limited liability companies; and
- the Insider Dealing and Market Manipulation Law 2005 (116(I)/2005).

The shareholding of a company registered and organised in accordance with the law may be acquired by a foreign investor by a number of methods, of which the most significant are described below.

### **Arrangements**

According to Section 198 of the Companies Act, a compromise or an arrangement may occur between the corporate entity and:

- its shareholders or any class of them;
- its creditors or any class of them; or
- any combination of the above.

The element of 'arrangement' is not limited to a compromise; the notion of 'compromise' assumes that a dispute has occurred. Both a company in the process of liquidation and an entity as a going concern may participate in the scheme regulated by Section 198. However, in both cases court approval is required. Approval will be refused if the scheme is deemed to be *ultra vires* under the memorandum of the company in question or contrary to the laws and regulations of Cyprus.

In order for the scheme to be binding on the company's shareholders or on a potential liquidator, the scheme must be approved by a 75% shareholding of the company and court approval must be conferred. Before permission will be granted, a declaration or statement must be made revealing any material interest that the members of the board of directors may have in the scheme and the impact of the proposed compromise and/or arrangement.

In the absence of a provision permitting a company to vary the class rights of its shareholders, Section 198 will apply in an attempt to give effect to such proposition. Additionally, the company will be given the opportunity to avoid a deadlock and achieve a compromise with a majority of its creditors, having the effect of being binding on all of its creditors.

Court approval will be granted once the court is satisfied that:

- the shareholders of the applicant company have been properly represented;
- the scheme in question is compliant with Section 198; and
- it would have been reasonably approved.

### **Reconstruction and amalgamation**

Sections 201(A) to (H) regulate mergers of public companies. Such merger may occur where a public company absorbs one or more public companies by transferring all the assets and liabilities of one entity to the other. The provisions will also apply in the event of the division of public companies and/or in respect of the merging of two public companies resulting in the formation of a new company.

The uncertainty that surrounds the reliance on conventional methods of raising finance (debt or equity finance), alongside the need to expand the horizons for new markets and investors, has led certain companies to join the Cyprus Stock Exchange. At present, approximately 300 public limited companies, along with their securities, are listed on the stock exchange, with the opportunity to raise the capital required by alternative means and thus boost their growth potential.

In order to effect a reconstruction and/or amalgamation of a company under Section 200 of the act, its board of directors must convene a board meeting in order to pass a resolution in respect of the reorganisation plan, as prepared by the company's auditors. In return, the auditors are responsible for ensuring that no tax complications will arise as a result of the proposed transaction. An application by summons must then be filed in the court by each company participating in the scheme for an order of the court to convene meetings of the companies concerned. On approval by the general meeting, final approval of the scheme must be sought before the court. For the order to be binding on all parties, the registrar of companies must be notified within seven days of the issuance of the order.

Sections 201(I) to (X) facilitate the merger of one or more corporate entities that have been organised and registered in line with the laws and regulations of a member state, with their central administration or registered office within the European Union. At least two of the entities to be merged must be governed by the laws of different member states. These provisions were introduced into the law in 2007 in an attempt to

harmonise the existing legislative framework with the EU Cross-Border Mergers Directive.

A cross-border merger under Sections 201(l) to (X) may occur:

- in the formation of a new corporate entity (used as a vehicle to facilitate the transaction), where one or more limited liability companies are wound up without going into liquidation and all of their assets and liabilities are transferred to a newly formed entity. As a consideration, the members of the target companies are issued with shares in the new company and paid a settlement amount in cash that does not exceed 10% of the nominal value of the shares issued or, when the shares do not attract any nominal value, of the accounting par value.
- by the acquisition of one or more limited liability companies by another company where:
  - a limited liability company is wound up without going into liquidation and all of its assets and liabilities are transferred to another company that in turn owns all the shares and securities representing its share capital; and
  - one or more limited liability companies are wound up without going into liquidation and all of their assets and liabilities are transferred to an existing company. In exchange, the members are issued shares in the buying company and paid a settlement amount in cash that does not exceed 10% of the nominal value of the shares issued or, when the shares do not attract any nominal value, of the accounting par value.

Any corporate entity registered and organised in accordance with the laws and regulations of Cyprus may participate in a cross-border merger, other than a company in the procedure of liquidation and a limited liability company by guarantee. Cyprus law has been shaped to facilitate the incorporation of straightforward procedures in respect of a potential intra-group cross-border merger. For example, the law does not require an expert report to be prepared or for the scheme plan to embrace information on share exchange ratio and related issues.

### **Control of concentration between undertakings**

In the event that a company registered in Cyprus plans to participate in a cross-border merger, the Control of Concentration between Undertakings Law (22(l)/1999) must be considered in order to evaluate whether there is a possibility of distorting competition within the market. According to the law, a 'concentration' occurs when:

- two or more independent undertakings are merged;
- one or more individuals that have control of at least one undertaking acquire, directly or indirectly, the whole or part of one or more undertakings; or
- a joint venture is established that may be presumed to not distort competition.

According to Section 3 of the law, a concentration is deemed to be of major importance if:

- at least:
  - two of the undertakings involved maintain a turnover that exceeds €3,417,202.88;
  - one of the undertakings involved engages in commercial activities in the territory of Cyprus; and
  - €3,417,202.88 of the aggregate turnover of all undertakings involved is respect of the disposal of goods or provision of services within the territory of Cyprus; or
- it has been declared as of major importance or of major public interest by an order of the minister of energy, commerce, industry and tourism.

If the proposed scheme falls within these thresholds, the parties concerned must notify the Commission for the Protection of Competition. The commission is empowered by law to:

- grant conditional or unconditional clearance; or
- declare that the proposed scheme is prohibited as it distorts competition.

If the proposed scheme has a community dimension, the commission must consult with the European Commission in Brussels before making its decision.

A public consultation procedure took place in September 2013 regarding the proposal of a new draft law regulating concentration control in Cyprus.

### **Tax implications: incentive to invest**

The attraction of Cyprus as an investment destination is arguably due to its favourable tax regime. In particular, its corporate tax rate (12.5%) is one of the lowest rates in the European Union. Corporation tax is imposed on the business profits of the entity, as

well as on royalties, rent from immovable property and profit realised from the sale of goodwill.

Depending on the structure of the business acquisition, different tax implications may arise. For instance, capital gains tax will not be levied on a corporate entity, except on gains resulting from the disposal of real estate located in Cyprus or disposal of shares in a corporate entity that owns real estate property situated in Cyprus.

Reorganisations within a group of companies, as well as takeovers, mergers, divisions and contributions of assets in exchange for shares, may occur without attracting tax consequences. Resident group companies can claim for a group loss relief (in the form of tax losses) and carry forward the loss incurred during a fiscal year between the companies in the group, subject to satisfying certain criteria. Trading in securities (ie, bonds, shares and debentures) is a tax-exempt activity; at the same time, the disposal of securities – irrespective of the number of shares involved, the nature of the gain and the shareholding period – attracts no tax.

There are no thin capitalisation rules in place. Nevertheless, under the Cyprus income tax legislation, a loan granted by a company registered in Cyprus to its directors and/or its members may attract annual interest of 9% of the loan granted. Otherwise, such advances cannot be considered as expenses incurred wholly and exclusively for the production of income.

Cyprus has established a wide double tax treaty network incorporating various favourable tax provisions. Cyprus recently entered into a double tax avoidance treaty with Ukraine, which will come into effect on January 1 2014. In addition, Cyprus has been officially removed from the Russian blacklist of offshore jurisdictions, thereby granting Cypriot corporate entities the opportunity to present themselves freely to the Russian market for outbound investments and allowing Russian corporate entities and investors to use Cypriot entities as a vehicle for investment purposes.

### **Protection of employees' rights**

During a cross-border merger, the board of directors of each company concerned must consult with its employees and/or with their representatives and provide information in respect of the proposed scheme.

Cyprus law has been amended accordingly in order to comply with the EU directives in respect of the protection of employees' rights of any corporate entity participating in a proposed restructuring. To that extent, a law relating to the maintenance and safeguarding of employees' rights in the event of transfer of undertakings, facilities or parts of business or facilities was enacted during 2000.

### **Comment**

The unique structure of the Cyprus economy and its relatively small size, along with the incentives to invest in Cyprus – either directly by acquiring a Cypriot company or indirectly by means of a merger – outweigh any potential disadvantages and the uncertainty resulting from the economic crisis. Although Cyprus must still face many challenges in this regard, it is arguably back on track.

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