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Mergers and reorganisations – an overview

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Introduction

Cyprus boasts an attractive merger and reorganisation regime not only locally (ie, between Cyprus entities), but also at a cross-border, EU level. Apart from the apparent and well-known advantages of merging two companies (eg, the creation of a stronger entity, the avoidance of liquidating group entities, the transfer of assets and liabilities without the need for the novation of contracts or other cumbersome procedures), mergers in Cyprus are also attractive from a tax perspective, as mergers and reorganisations which fall within the scope of the law may well result in a total exemption from tax in Cyprus.

Local mergers

Section 30 of the Income Tax Law (118(I)/2002), as amended, defines a local merger between Cyprus companies as an act where:

- one or more companies, on their dissolution without going into liquidation, transfer all of their assets and liabilities to another existing company in exchange for the issue to their shareholders of shares in the capital of the receiving company and potentially in exchange for cash, not exceeding 10% of the nominal value of the shares or, in the absence of a nominal value, of the accounting par value of the shares;
- two or more companies, on their dissolution without going into liquidation, transfer all of their assets and liabilities to a new company that they establish in exchange for their shareholders being issued with shares in the new company's capital and, potentially, in exchange for cash, which should not exceed 10% of the nominal value of the shares or, in the absence of a nominal value, of the accounting par value of the shares; or
- a limited liability company, on its dissolution without going into liquidation, transfers all of its assets and liabilities to a company holding all the shares representing its capital.

A 'company' is defined by the Companies' Law, Cap 113, as amended, as "a company established and registered pursuant to the Companies' Law". This includes all entities with a legal personality or an organisation of public law, as well as all companies, fraternities or other associations of persons with an acquired legal personality, but not partnerships.

The Income Tax Law classifies mergers and divisions (demergers), partial divisions, asset transfers and share exchanges as arrangements, all of which are carried out pursuant to Sections 198 to 201 of the Companies' Law, relating to compromises and reorganisations (or arrangements and reconstructions as in the original English text). Sections 201A to 201H of the law apply to public companies.

Local mergers must receive court approval before they can be conducted. Mergers result in the transfer of the assets and liabilities of one company to another and the dissolution of the first company without it going into liquidation. The relevant formalities include the passing of a resolution of the absorbing company's board approving the merger and the proposed deed of arrangement, which is then put before shareholders for approval and ratification. A deed of arrangement is entered into, accounts are prepared and consent from creditors, if any, are obtained. All merger documents, together with the constitutional documents of the absorbing company, are attached as exhibits to two petitions that are filed with the relevant district court. One petition is for directions to dispense with the need to apply to court to convene a shareholders' and creditors' meeting regarding the companies proposed to be merged, as the shareholders' meeting will have already taken place and creditor consent letters obtained. The other petition is for approval of the proposed merger.

If the court is satisfied with the content of both petitions, it may issue the merger order immediately or reschedule the hearing of the main petition for another date and request the filing of a supplementary affidavit with further information in the meantime. Following the issue of the merger order, it must be filed with the registrar of companies who will proceed with issuing the certificate of dissolution for the company being absorbed and dissolved. The certificate of dissolution is the official document evidencing the completion of the merger and contains the date on which it becomes effective (ie, the date on which the registrar of companies receives the court order and the accompanying documents, unless the deed of arrangement specifies an effective merger date). Although a merger is not effective until the registrar of companies processes the documents filed, once processed, the merger and consequently the dissolution of the absorbed entity takes effect retrospectively.

Cross-border mergers

As far as cross-border mergers are concerned, following the repeal of the EU Directive on Cross-Border Mergers of Limited Liability Companies (2005/56/EC) by EU Directive 2017/1132/EC relating to certain aspects of company law, Chapter II of the 2017 directive applies, which sets out simplified provisions relating to the cross-border mergers of limited liability companies.

Cross-border mergers can take place between limited liability companies incorporated in accordance with the legislation of an EU member state that have their registered office, central administration or principal place of business in the European Union, provided at least two of them are governed by the laws of different member states (Article 118 of EU Directive 2017/1132/EC).

Under Chapter II of EU Directive 2017/1132/EC, a 'limited liability company' means a company:

- listed in Annex II of the directive;
- with share capital that:
  - has legal personality;
  - possesses separate assets which serve to cover its debts; and
  - is subject, under the relevant national law, to conditions concerning guarantees such as those provided for by Section 2, Chapter II, Title I and Section 1, Chapter III, Title I of the directive for the protection of interests of members and others.

Chapter II of EU Directive 2017/1132/EC defines a 'merger' as an operation whereby:

- one or more companies, on being dissolved without going into liquidation, transfer all of their assets and liabilities to another existing company (an acquiring company) in exchange for the issue to their members of securities or shares representing the capital of the other company and, if applicable, a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities or shares;
- two or more companies, on being dissolved without going into liquidation, transfer all of their assets and liabilities to a company that they form (a new company) in exchange for the issue to their members of securities or shares representing the capital of that new company and, if applicable, a cash payment not exceeding 10% of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities or shares; or

- a company, on being dissolved without going into liquidation, transfers all of its assets and liabilities to the company holding all the securities or shares representing its capital.

According to Article 121 of EU Directive 2017/1132/EC, save as otherwise provided in Chapter II thereof, cross-border mergers are possible only between types of company that can merge under the national law of the relevant EU member state. A company taking part in a cross-border merger must comply with the provisions and formalities of the national law to which it is subject. These provisions and formalities must include those concerning the decision-making process relating to the merger and, considering the cross-border nature of the merger, the protection of creditors of the merging companies, debenture holders and the holders of securities or shares, as well as of employees as regards rights other than those governed by Article 133 of the directive. An EU member state may, in the case of companies participating in a cross-border merger and governed by its law, adopt provisions designed to ensure appropriate protection for minority members that have opposed the cross-border merger.

The procedure to carry out a cross-border merger as above is as follows:

- The management of each merging company draws up the common draft terms of cross-border mergers, containing the particulars listed in Article 122(a) to Article 122(l) of EU Directive 2017/1132/EC.
- The common draft terms are filed with the registrar of companies insofar as the Cyprus entity is concerned and publication of the same in the *Official Gazette* takes place. The analogous procedure takes effect in the other EU member state in accordance with applicable law and regulations.
- The management of each merging company draws up a report intended for members explaining and justifying the legal and economic aspects of the cross-border merger and the implications of the same on members, creditors and employees.
- An independent experts' report for each merging company must be obtained if required. Under Article 125(4) of EU Directive 2017/1132/EC, neither an examination of the common draft terms of cross-border mergers by independent experts nor an expert report is required if the members of each of the companies involved have so agreed.
- Following the expiration of the relevant timeframes set out in the respective laws of each EU member state, a general meeting of each merging company must be convened to approve the common draft terms of the cross-border merger.
- An initial application must be made to the district court where the registered office of the Cyprus company is situated, requesting a certificate which conclusively attests to the proper completion of the pre-merger acts and formalities. The district court will issue the pre-merger certificate after scrutinising the legality of the cross-border merger as regards that part of the procedure which concerns the Cyprus company, if satisfied that it is in order. An analogous procedure is followed in the other EU member state.
- Depending on which entity will survive the merger, the relevant steps must be taken in the relevant EU member state for the merger's completion. The cross-border merger will take effect according to the national legislation of the relevant EU member state of the absorbing company and the relevant authorities will communicate between themselves regarding the necessary notifications.
- Once the notifications have been made to the competent authority of the dissolved entity, the competent authority will proceed with the recording of the dissolutions of the same.

The consequences of a cross-border merger are contained in Article 131 of EU Directive 2017/1132/EC. In all cases, all assets and liabilities are transferred without the need for any other action (save for any necessary notifications) and likewise, the company or companies being absorbed cease to exist. From a tax perspective, an application can be made to the Revenue Department, accompanied by the reorganisation plan and relevant information on the merging entities, for a reorganisation certificate, confirming the exemption from taxes. The tax authorities retain the discretion to issue a tax exemption certificate if they take the view that the merger or reorganisation was at arm's length and reflected economic reality.

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