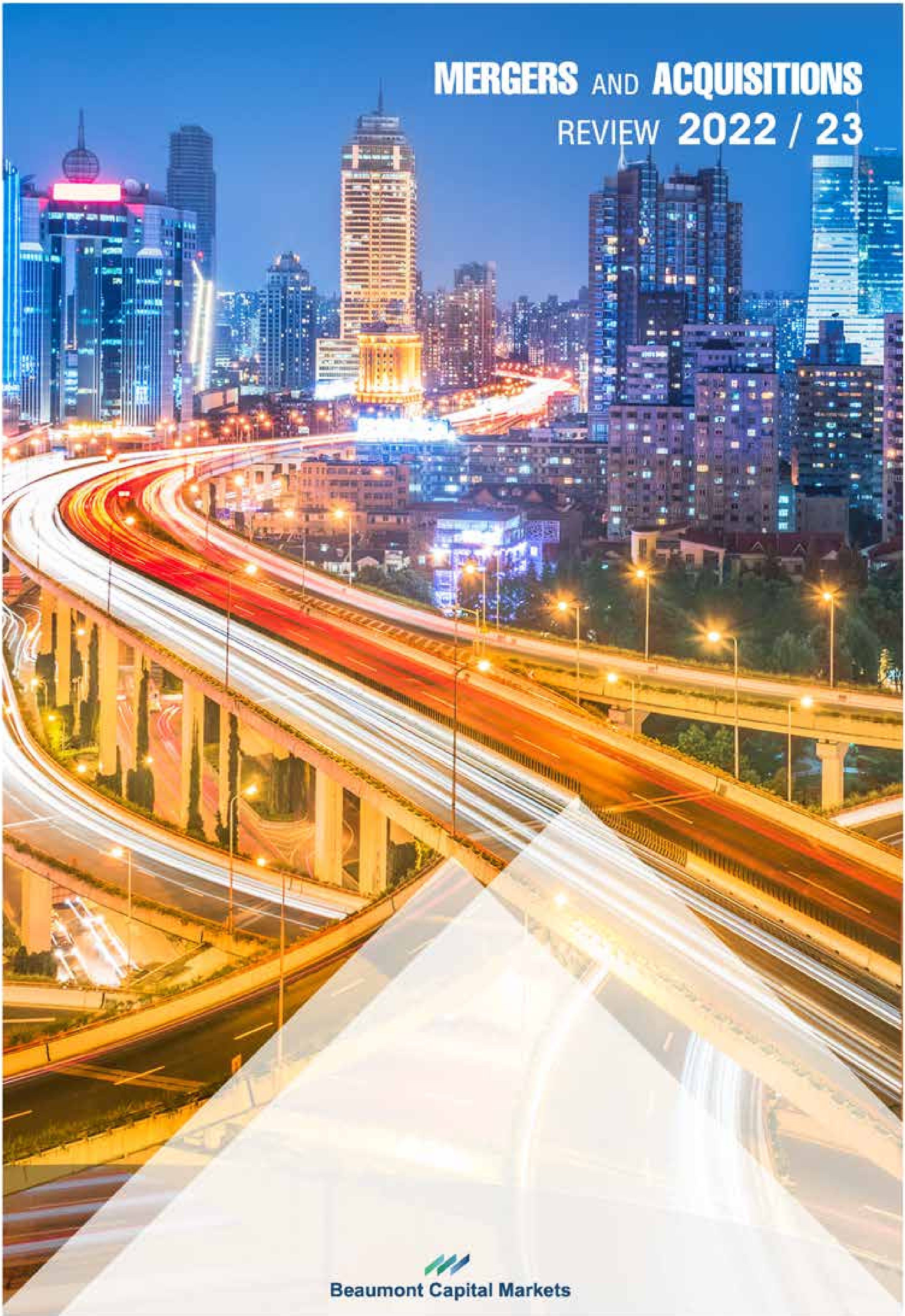
MERGERS AND ACQUISITIONS REVIEW 2022 / 23



Beaumont Capital Markets

The International Mergers & Acquisitions Review 2022/23

Content

BRAZIL

A Couple of Very Basic Concepts of Brazilian M&A

Restrictions on Foreign Investments and Capital Controls

DEMAREST

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BIO

Thiago Sandim graduated in 1997 from the Pontifical Catholic University of São Paulo (PUC-SP) and also holds a certificate of mastery in negotiations issued by the Harvard Business School online in 2020. He is a partner of the Mergers and Acquisitions and Private Equity practices of Demarest Advogados, having led the buy-side of the two largest and award winning PE investments (deployment of capital through IMG and IPO stages) of the country (Banco BTG Pactual S.A. and Rede D'or São Luis S.A.).

Among his regular clients are sovereign wealth and large foreign pension funds, as well as Brazilian financial institutions and infrastructure conglomerates. Thiago has experience as a non-executive member of boards of directors of retail, real estate development and financial companies. His performance is recognised by major global and local legal rankings.

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Introduction

Me and most of my colleagues started on the M&A legal business back in the 90s. At that time, most of the international M&A business would come from US based companies, in the form of investments in the Brazilian "old school" industry. The financial and capital markets were very small and risk investment virtually not feasible as a result of the high inflation and institutional instability.

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> most of the international M&A business would come from US based companies, in the form of investments in the Brazilian "old school" industry.

That landscape changed very fast in the late 90s, with the surge of the privatisation. By the early 2000s, We had seen and had the pleasure to work with colleagues from several nationalities, from all over Europe and the Americas. The surge of the commodities, the intense need of the Asian markets either for the supply of these goods or new markets to explore, coupled by the institutional stability of Brazil are now bringing a new type of investors into Brazil. Large international private equity funds, sovereign wealth funds and large Asian companies and banks are now joining (and sometimes getting more important than) the Europeans and Americans. On top of that some of the local players have matured and developed into global class players. The current situation of Brazil looks gloomy for untrained eyes, but democracy is stable, there are 230 million people to feed, the last war with neighbouring countries occurred mode than 150 years ago (which is an important data when one considers the current Ukraine/Russia situation). Moreover, the government expenditure during COVID-19 was significantly lower than that of our peers vis-à-vis the internal gross product. Finally, there is little room for failure and the government knows it. Any government – which is another important fact to remark, as this is an election year.

Over the years and as a result of our global approach and overseas business development efforts, we also learned that these new investors are eager for information about how to properly do business in the country. Be it for the huge geographical distance or for the just recently acquired capacity to do cross-border M&A, such new investors have very limited access to information on the local legal landscape or the pitfalls that they may face when they are first investing in the country.

It is mostly these readers that this article targets.

Of course we do not have the intention to be comprehensive or even to be highly technical, but will try and put in a nutshell some very basic local legal concepts that are very straightforward knowledge for Brazilian lawyers and transactional personnel, but that we learned over the year may sound very strange in foreign ears.

With some noticeable exceptions. It is these exceptions that this article targets.

So here is our attempt to put some basic issues in a nutshell. We do that because some of our fellow colleagues from other nationalities may not be familiar with the very basic legal concepts that are valid in Brazil. In our mind, it is only a matter of creating awareness and making such concepts familiar, as Brazil is as investor friendly as any of the most advanced countries in the world.

Here we go.

Chapter 1 - Restrictions on Foreign Investments

The last constitution enacted in the country dates back to 1988. It was generally a constitution designed to protect the Brazilian business, while at the same time creating an environment that would attract foreign investments. It initially created a distinction between Brazilian companies controlled by Brazilian entities or nationals and Brazilian entities controlled by foreigners. This particular distinction created the basis for restrictions that were passed under the form of "ordinary" laws, which are significantly easier to pass in Congress. Late in 2001, when this distinction proved to be unrealistic and counterproductive, the constitution was changed to eliminate it. This made restrictions to foreign investments harder to approve because they need to be on the Brazilian constitution, or be based on the Brazilian constitution. By eliminating the distinction between entities controlled by Brazilians and entities controlled by foreigners, the country basically eliminated the broad concept that foreigners and companies controlled by foreigners may receive treatment different than that awarded to Brazilians. Today, a company incorporated in Brazil is considered to be a Brazilian entity, irrespective of its shareholders. This is a significant difference when one compares the Brazilian legal landscape with that of other BRICS – China, in particular.

Of course there are still restrictions in place, but they tend to be limited to activities that are considered to be strategic by the country. The restrictions can be very basically divided in 3 types.

The first type would be activities that are 100% reserved to Brazilian nationals and companies controlled by Brazilian nationals (sometimes with 100% of the shares). Economic activities in the borders of the country can be quoted as a good example of this type of restriction. Whilst, for example, the ownership of real estate by Brazilian nationals may not be an issue, on the borders of the country they are restricted to foreigners. This type of restriction is to be taken very seriously. Some mining and pulp companies had problems to exercise their activities in these areas due to aggressive legal structures that were later disregarded by the Brazilian authorities. It is also important to understand the background of this particular restriction, which lies in the fact that Brazil has one of the largest continuous borders in the world. A very large portion of this border is in the Amazon, where vigilance is almost impossible. On top of that, unlike, for example, the USA (which also has a very large border) Brazil has borders with all South American countries but Ecuador and Chile. This makes us a US size type country, with European - type complex borders. There are also restrictions with regard to the amount of land that may be held by a foreign in a single municipality, which was created because at a stage in the late 2000s very large pieces of land were being acquired by companies controlled by foreign governments, which the Brazilian executive branch considered worth paying attention to.

The second type of restriction applies to markets were foreign investment is limited to a certain threshold. As Brazilian corporations can have voting and non-voting stock, the restrictions can be applicable in a different manner for voting and non-voting stock, depending on the industry. In media companies, for example, total foreign investment is limited to a certain percentage of the capital stock of the company, whilst in airlines it has no limits for non-voting stock and a percentage threshold for voting stock. This last one creates a curious situation – if one takes a look at the securities of Brazilian airlines which are traded in the São Paulo stock exchange, it will become clear that only "IPO companies" (companies which are at the level of the parents of the operational company) are the companies that are actually listed or that a very strong lock-up is in place with regard to the common voting shares of these companies -or, alternatively - that there is a lockup in the documents of the IPO, restricting the ability of the controlling shareholders to float a number of shares beyond such thresholds. Media and airliners are not the only markets with restrictions in place, but the more visible. The markets with this type of restriction in Brazil are regularly seen in other countries.

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There are finally some markets in Brazil where foreign investment depend on the "declaration of interest by the government". This is pretty much limited to the financial industry, where the government wants to examine on a case-by-case basis where it would be of interest for the country to welcome a given investor or not. This was inserted in the constitution of 1988 and was put in the hands of the president of Brazil – which made the task to get the declaration of interest very delicate, to say the least. Over time it became obvious that such a deep control was obviously not in the interest of the government, and also that the restriction was preventing the Brazilian financial institutions to capitalise through equity in the open markets. This is because, in theory, every investor buying equity of a Brazilian financial institution in the open market would require an express authorisation of the president of Brazil, which is obviously impossible This problem was solved through "umbrella decrees" which basically treat every foreign investment in non-voting stock of Brazilian financial entities as "of interest of the country". This was the basis for the first wave of IPOs of non-voting shares of Brazilian companies, which followed this decree.

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To this date it is also unusual that the president refuses to grant the decree to a foreign institution that acquires control of a Brazilian company. I have indeed seen foreign institutions get refused, but that is usually implemented through informal advise by the Central Bank of Brazil (which is responsible for the technical analysis of the cases) for the foreign applicants to withdraw their requests before they are formally denied. It is also important to notice that, as foreigners can not actually acquire the voting stocks before the decree (unless there is already a decree authorising such acquisition), there is usually a 6 to 8 months period ranging from signing to financial closing.
In acquisitions involving financial institutions it is hence very important that the approval process is managed professionally, involving not only lawyers, but also other advisors who are familiar with the Central Bank procedures and formalities. It is also very important to bear in mind that unlike some banking regulatory agencies throughout the world, there is frequently no deadline for approval of transactions by the Central Bank of Brazil, which tends to make the approval process much more complex than usual.

Over time, I have watched lawyers and investment bankers come up (and have designed some myself) with sophisticated "negative control" structures, mostly based on debt, to overcome or stretch these restrictions to their limit. Our general advise to our clients in this case is generally very conservative. Do not do it. If the government does not want foreign investment or restricts foreign investment in a certain market, one may discuss the merits of the restrictions and the interest of the country to continue with them. But the law is there to be followed, and not to be creatively circumvented.

In a nutshell, what you need to keep in mind from this Section is, thus, that with very specific exceptions, Brazilian law does not create different treatment for local entities based on the nationality of their shareholders.

Foreign Exchange Controls

This is something that European clients have some trouble to understand, particularly in light of the existence of the Euro for quite some time (Brexit will certainly shed some light on similar situations in Europe). Although the Brazilian currency is freely tradable, the government keeps a close scrutiny of the balance of payments, and that is implemented in practice through the electronic registration of every exchange transaction of Brazilian currency with the Central Bank of Brazil. It is called electronic declaratory registration system. Not to be confused with a system which requires authorisation for a transaction to be implemented. As defined by its own name, it is a system where the interested parties declare the facts (amount invested, equity or debt transaction, etc.) and implement the transaction, in principle, without the need of a prior authorisation of the Central Bank.

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The "catchy" bit of the foreign exchange control is that only financial institutions authorised to deal in the foreign exchange markets by the Central Bank of Brazil may implement those transactions. Such institutions need to keep a paper trail of every transaction they implement for a certain period of time in case the central bank wants to clarify something. If the Central Bank tries to gather information on a given transaction and such information is not available, the financial institution may be subject to sanctions (that can range widely at the discretion of the central bank from a warning to the suspension of the financial institution to trade in the foreign exchange markets). As no financial institution wants to be exposed to this type of problem, it is almost impossible to invest in Brazil without being in full compliance with the regulatory requirements – essentially because the financial institution channelling the investment would not allow it to happen.

There are basically two ways to invest in equity in Brazil. Portfolio investments and foreign direct investments. Both are registered in the electronic registration system of the central bank, but serve different purposes and can generate different tax consequences. The Electronic registration system of the central bank of Brazil also registries financial transactions (debt related) and export and import transactions, among other. This article, however, only refers to equity transactions, mostly in a non-technical style, as made clear in the beginning of the text.

Portfolio investments are essentially investments in the Brazilian capital markets (debt or equity). They could be broadly defined as a type of registry that has an "umbrella amount" and several types of securities held beneath such umbrella amount. The holder of the portfolio investment is allowed to change the securities without the need to create a new registration – which is only required upon the repatriation of capital. Portfolio investments are entitled to some tax benefits in certain circumstances. On the other hand, they are generally currently subject to a higher taxation by the tax on financial transactions (Imposto sobre Operacoes Financeiras – IOF) at the time of their implementation. As this tax is classified as a "regulatory tax" (which rates can be increased or reduced as the government considers appropriate given specific market conditions) one needs to check what rate is applicable at the time of the investment.

The portfolio investments are usually the preferred route for foreign private equity institutions to invest in the country, as provided that some regulatory tax requirements are met, in theory there could be no income tax due upon the repatriation of the investment from the Brazilian capital markets. What essentially happens is an initial investment in quotas of Brazilian private equity funds (the so-called FIPs - Fundos de Investimento em Participacoes) which are at a given stage collapsed into equity of the companies beneath it, which are then sold in the capital markets and repatriated. Of course the whole structure is much more complex than what is described above, but this is a good non-technical description.

Financial institutions are also allowed to create "omnibus portfolio accounts", which carry investments of several of their foreign clients. However, each client has a "sub-account" that is clearly identified to the central bank of Brazil. This is necessary not only to keep the financial authorities up-to-date about those investing in Brazil (for money laundering purposes, for example) but also to allow the exchange of information between several branches of the Brazilian government. The central bank and the securities commission, for example, are known to have identified disguised stake building exercises by crossing the disclosure of material facts issued by the companies with the updates of the electronic registration system.

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Foreign direct investments are straight forward investments in the capital stock of Brazilian companies, implemented outside the stock markets. The amount of the registration is linked to the asset (shares or quotas in the case of Brazilian limited liability companies) beneath it. Registration must be changed every time the asset changes. It is a more solid and non-flexible registration system mostly designed to reflect the long-term investments in the country.

Most important of all, the correct registration of foreign capital invested in Brazil with the central bank is important because it serves as the main basis for the Brazilian tax authorities to access the original cost of a given investment in the country, which is the basis for the calculation of the withholding income tax on capital gains (the main tax assessing the sale of securities in Brazil by foreigners). If the registration is incorrect (or in the slang of the Brazilian capital markets "tainted") the odds are that the foreign investor may have problems to prove the acquisition cost at the time of the repatriation of capital. In extreme cases, the cost of investment could be considered as being zero, which would most certainly reduce the gains or even create losses.

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CYPRUS

Overview of the Cyprus M&A key trends and developments

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Kyriacos Scordis is the managing partner of SCORDIS PAPAPETROU & Co LLC. Among others, he has in depth expertise on public and private M&A transactions, group re-organisations, banking and finance, company & commercial law, corporate governance matters, international cross-border and other corporate transactions.

He has advised on and acted as counsel in various corporate matters including cross-border sales & acquisitions of Cyprus and non-Cyprus assets, with recent notable projects including the underwriting of a major Cyprus listed company in the capital increase of the second largest Cyprus bank, and the billion USD debt restructuring of a major global player in the building material sector.

He was counsel in major international disputes with appearances before various tribunals and Courts for claims amounting to USD billions. He is a member of Lincoln's Inn, Inns of Court (Barrister at Law), the Cyprus Bar Association, the International Tax Planning Association and the International Bar Association.

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BIO

Constantinos Adamides is the head of the Limassol (Cyprus) office. His main areas of practice are Corporate Law, M&A, Joint Ventures, Tax Law, Finance, Immovable Property, Corporate & Commercial Litigation and Arbitration.

His notable recent engagements include a multimillion complex acquisition of a luxury Cyprus resort which involved the restructuring of a multi-million debt, acting as head Cypriot counsel of a private Cyprus holding company in a highly complex acquisition for the extraction premises of a primary energy source, and advising a FTSE Cyprus public company in a joint venture agreement with another Cyprus listed company for joint participation in the consortium acting as the contractor in two major water desalination BOT projects in Cyprus.

He has written several legal articles in leading law journals and has been a guest speaker in seminars covering topics on, among others, international tax law. He is a member of the Cyprus Bar Association.

M&A in Cyprus by and large follows global trends, with a particular emphasis of events due to its natural links to Greece, as well as its location and popularity as a regional business hub and financial centre. The global reach and effect of the COVID-19 pandemic in the past years has led to the rethinking and reinvention of ways to do business, with online working and digitalisation gaining a momentum which has been since solidifying. Cyprus did not remain unaffected by the new norms and circumstances, however it did have one of the lowest growth reductions in the EU, with the various sectors repositioning and re-targeting projects to address new markets and clientele.

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Following an initial pause on M&A transactions in the first three quarters of 2020, the fourth quarter saw deals starting to materialise, and the increasing trend continued well into 2021 and 2022, as businesses adapted their outlook and strategies by choosing to (among others) spend accumulated cash on carefully structured acquisition deals. This was further enhanced by economic stimulus packages and the gradual easing of restrictions, which further allowed for physical meetings and travelling. M&A activities in 2021 and 2022 revolved mainly around banks/non-performing loans, the tourist industry, real estate, renewable energy, telecommunications and the health sector. The areas and sectors that are expected to continue to generate interest are the financial services sector (both with consolidations and acquisitions), technology and digitalisation as more companies seek to enhance their digital and technological channels, and the tourism sector, following the lifting of travelling restrictions.

Legal and Regulatory Framework

Cyprus is a common law jurisdiction, with a continental public law approach. Being an EU member state, European law has supremacy over domestic laws and the Cyprus Constitution.

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The legal and regulatory framework allows for the following methods in acquiring a company:

- Purchase and transfer of a company's shares from an existing shareholder, most commonly structured through a share sale and purchase agreement;
- By way of subscription to a new share issue, which can be private or public;
- A restructuring (such as merger, or partial demerger);
- Court sanctioned scheme of arrangement.

Mergers and restructuring of private and public companies are effected with the application of the provisions of the Companies Law CAP 113 (as amended) which regulate inter alia mergers (including reverse mergers with the subsidiary company absorbing its parent company), divisions, partial divisions, transfers of assets and exchange of shares in two or more companies merging together, mergers of public companies in accordance to EU practices, and cross-border mergers between Cyprus companies and companies incorporated in other member states of the European Union.

The EU Cross-Border Mergers of Limited Companies Directive (2005/56/EC) was transposed in the Companies Law, and in recent years there has been a rise in cross-border mergers involving Cyprus companies.

An M&A transaction may also be regulated, depending on its circumstances, by the following legislation:

- the Cyprus Securities and Stock Exchange Law 14(I)/1993 (as amended) which is relevant to public mergers and acquisitions;
- the Transparency Requirements (Securities Admitted on a Regulated Market) Law 190(I)/2007 (as amended);
- the Market Abuse Law 102(I)/2016, transposing the EU Market Abuse Regulation EU 596/2014;
- the Protection of Competition Law 13(1)/2022;
- the Preservation and Safeguarding of Employees' Rights on the Transfer of Business, Facilities or Parts of Business or Facilities Law 104(I)/2000 (as amended), which protects the rights of employees on the transfer of a business;
- the Control of Concentrations between Undertakings Law 83(I)/2014, transposing the EU Merger Regulation (the Council Regulation EC No. 139/2004 on the Control of Concentrations between Undertakings), regulating undertaking concentrations and requiring clearance by the Cyprus Competition Commission;
- the Claim of Damages Law for Breach of Competition Law Matters 113(I)/2017, which sets rules where upon any wronged physical or natural person or public authority which has suffered a damage by an infringement of competition law by an undertaking or concentration of undertakings can effectively seek damages against the wrongdoers, and
- the Corporate Governance Code issued by the Cyprus Stock Exchange.

The primary regulators for M&A activity are:

- the Cyprus Stock Exchange (for listed entities or M&A affecting/relating to such entities);
- the Cyprus Securities and Exchange Commission, in relation, inter alia, to public takeover bids under the Takeover Bids Law, the Market Abuse Law or entities involved in the provision of financial services; and
- the Cyprus Commission for Protection of Competition, in relation to competition (anti-monopoly) law matters.

To the extent M&A activity may have an effect on creditors (for example, in the case of a merger), there will be Court involvement in sanctioning the scheme.
Any merger plans and changes to shareholding, management or governance (for example, amendment to the articles of association of a company) are filed with the Cyprus Department of Registrar of Companies and Intellectual Property, the relevant record-keeping body of the information relating to both private and public companies. Its function is not regulatory as such, and the changes filed are not subject to its approval (except for limited cases, such as change of name).

When an M&A transaction is taking place within a regulated industry, such as banking, insurance, investment management or the funds sector, prior relevant regulator approval will need to be sought. Further, certain mergers need to be cleared by the Cyprus Commission for Protection of Competition prior to their implementation, in accordance with the Cyprus Law for the Control of Concentrations between undertakings, when the aggregate turnover by at least two of the participating undertakings is more than €3,5 million, and the combined aggregate turnover of all participating undertakings within the Republic of Cyprus is at least €3,5 million.

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There is no specific legislation to act as a national security review of acquisitions. However, the Prevention and Suppression of Money Laundering and Terrorist Financing Law 188(I)/2007 (as amended), may be relevant as transactions need to be checked for money laundering or any kind of illegal activity and/or terrorist financing.

M&A transactions in practice

Most M&A activity in Cyprus is in the form of direct offers/bids (whether by existing shareholders or third parties) or purchase of distressed assets. Stakebuilding exercises are rare, especially in view of the small size of the Cypriot economy and the market in question.

The main hurdles to stakebuilding are obtaining shareholder approvals from the target company to accept the bid, securing the necessary financing before announcing the bid and obtaining the necessary regulatory sector or activity specific approvals. The minimum reporting thresholds specified under the applicable legislation must always be met.

A person whose shareholding following an acquisition or disposal of listed shares (either listed on the Cyprus Stock Exchange or in any regulated market of any other EU member state) with attached voting rights either reaches, surpasses or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% of the total voting rights in the issuing company, must notify the issuer, the Cyprus Securities and Exchange Commission and the Cyprus Stock Exchange of such a transaction.

"Shareholders do not need to make known the purpose of their acquisition in private or public companies, however, if a bidder is making a takeover bid, they must draw up an offer document.

Additionally, for any acquisition which takes place during a takeover bid period by a bidder who holds 5% or more of the voting rights of the target company, details of the acquisition transaction must be disclosed to the target company's employees, its board, the Cyprus Stock Exchange, the Cyprus Securities and Exchange Commission and a relevant announcement must be made. Anyone acquiring 0.5% of the voting rights of the target company or the bidder must announce the acquisition and all subsequent acquisitions and their details.

Shareholders do not need to make known the purpose of their acquisition in private or public companies, however, if a bidder is making a takeover bid, they must draw up an offer document, which must include amongst other information the bidder's intention with regard to the future business of the target.

With respect to public companies[1], in the event a person acquires (directly or indirectly) securities that causes them, together with their existing holding (whether on their own or together with others acting in concert) to have 30% or more of the voting rights of the target (public) company, such person is obligated to immediately address a bid to the remaining shareholders, for the purposes of acquiring their shares (mandatory acquisition offer). Such mandatory offer provisions will also be triggered in the event of persons holding between 30% and 50% of the voting rights in the company, in the event that they wish to increase their holding. The proposed consideration must be at least equivalent to the highest price paid or agreed to be paid for the respective securities by the bidder or by the persons acting on behalf of the bidder, during the 12 months prior to announcing the bid. A partial voluntary offer to acquire shares in a (public) company is possible (including for shareholders with less than 30%) with the consent of the Cyprus Securities and Exchange Commission, and in such a case the bidding party may set conditions on the price level as well as minimum or maximum number of shares to be acquired.

The acquisition process can vary from transaction to transaction, depending on the complexity of the deal and the businesses involved. There is no specific timetable or any time restrictions, especially when it involves private companies. Public companies' acquisitions, however, are given a guideline concerning the period of acquiring or selling a company, deriving from the Takeover Bids Law 2007. Public companies which have been presented with a public takeover offer generally require at least four to six months, subject to such an offer comprising of cash consideration and conditional to any applicable squeeze-out provisions.

1. Mandatory offer provisions do not apply to private companies.

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There are no express provisions requiring disclosure of M&A transactions under the Companies Law until completion of the procedure, where the relevant filings will need to be made with the Registrar of Companies, in respect of the change of shareholder in the company. Generally, Cyprus public M&A transactions are disclosed following either a possible or actual "leak" or upon a bidder definitively deciding to make an offer. According to the Takeover Bids Law, it is the bidder who has the obligation to announce its decision when it is final and it has every reason to believe that it will be implemented or upon the acquisition of securities which give rise to an obligation to make a bid.

The implementation of Regulation (EU) No 910/2014 on electronic identification and trust services for electronic transactions in the internal market, which was incorporated into domestic law as the Electronic Identification and Trust Services for Electronic Transactions in the Internal Market Law 55(I)/2018, has facilitated the application and acceptance of electronic signatures at a time where remote-working and restrictions in movement were mandated, thus enabling the conclusion of transactions even during times where physical meetings and travelling were not possible.

Following an M&A transaction and in the event of a dispute, it is noted that post-Brexit, judgments issued by a Court in the United Kingdom, British dominions, protectorates and mandated territories may be recognised and enforced in Cyprus pursuant to the Foreign Judgements (Reciprocal Enforcement) Law Cap 10. Judgements obtained in EU Member States are subject to recognition and enforcement in accordance with the relevant EU framework, while foreign judgements issued by a competent court of a jurisdiction with which there is a concluded bilateral or multilateral treaty for the recognition of judgements are also recognised and enforceable in Cyprus under the relevant domestic law.

Notable and highly publicised M&A transactions

In March 2022, the second-largest Cyprus banking institution acquired the portfolio of performing, well collateralised and mainly corporate loans of another Cyprus bank, with the latter also changing its corporate structure to mitigate exposure due to escalating geopolitical tensions. The portfolio was valued at €556 million, comprising of loans of Cypriot, EU and UK exposures in hotel and accommodation, commercial real estate, construction and development, renewable energy education, food and beverage, manufacturing, wholesale and retail trade.

In April 2021, there was a multimillion complex acquisition of the only luxury internationally branded resort in Cyprus, by the subsidiary of a Greek real estate investment company, which involved inter alia the restructuring of a multi-million debt generated as a result of the extensive renovation and construction works at the hotel. The high - profile deal, which was structured and implemented during the lockdowns and restrictions inevitably imposed as a result of the pandemic, demonstrate the drive and determination of the various Cyprus sectors involved to be efficient, effective and reliable.

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The 2020 acquisition of Noble Energy by Chevron also had a Cyprus dimension, as Noble energy possesses the majority stake in a license for hydrocarbon exploration in Block 12 of the Cyprus Exclusive Economic Zone in the eastern Mediterranean Sea. The Aphrodite field discovered within Block 12, has gross mean natural gas resources of approximately four trillion cubic feet. Given the current energy crisis, the discovery of natural gas may be met with renewed interest for its swift extraction, which will in turn create business interest and opportunities in the relevant sector.

Other notable developments

The Cyprus government in the meantime continued to pursue its structural reforms by introducing incentives to encourage foreign investment, such as the start-up visa for non-EU nationals and a Fast-Track Business Activation Mechanism for non-EU nationals in September 2020, aimed at attracting high-calibre professionals, whether as part of relocating foreign business or as digital nomads.

The technological advancement and reform of the judicial system will provide further opportunities for structuring M&As. In 2021, the e-justice platform serving the entire judicial process in Cyprus by facilitating lawyers and law firms, judges, Court personnel and users authorized by the Cyprus courts to have electronic and online access to court proceedings, was officially launched. The reforms are a result of the direct co-operation of the legal world, the Courts and the government (including the Cyprus Deputy Ministry of Research, Innovation and Digital Policy established in 2020, which has been at the forefront of all recent digital reforms in Cyprus).

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It should also be noted that the Corporate Governance Code issued by the Cyprus Stock Exchange, directed towards listed companies, whose purpose is primarily to promote greater transparency and sufficiently safeguard the independence of the board of directors in decision making, was revised in 2019 to further reinforce and promote greater transparency in corporate governance of companies.

Conclusion

Although Cyprus did not remain unaffected by the new norms and circumstances, it did remain determined to continue on its course in constituting an attractive, comprehensive and cost-effective jurisdiction for doing business. Both the private and public sector were quick to adapt and react in dealing with the challenges created by the initial shocks as lockdowns and government restrictions were imposed, and in addition Cyprus remained on course with its plans to modernise and streamline its economy and judicial system.

GERMANY
M&A in Germany: Market Trends and Developments

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With over 25 years' experience as a partner and legal lead in the Corporate/M&A practice areas of Freshfields and PwC Legal, Nikolaus has vast experience advising national and international corporates as well as private equity funds on all aspects of M&A transactions, legal due diligence, and, in particular, negotiating transaction agreements. Nikolaus also has a comprehensive knowledge of valuation topics and their impact on M&A agreements and regularly advises on joint ventures and corporate reorganisations.

Nikolaus is recognised by JUVE, the German equivalent to Legal 500 and Chambers, as a recommended lawyer for both M&A and Private Equity. The leading German business & financial newspaper "Handelsblatt", in association with the US publisher "Best Lawyers" also lists Nikolaus as a recommended lawyer for M&A.

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As a counsel at Lupp + Partner David specialises in domestic and cross border M&A transactions and corporate reorganisations. He also regularly advises on general questions of corporate law, corporate compliance and housekeeping matters and joint ventures. His clients comprise company owners, all corporation sizes, investors and start-ups from various jurisdictions and sectors.

A specific focus of David's work is advising German and international company owners, medium size companies and multi-national corporations on the structuring and implementation of complex M&A transactions and reorganisation projects, usually involving a multitude of jurisdictions.

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It is no secret that private M&A is a secretive business and numbers on deal values and deal volumes can, therefore, have little more than an indicative value. However, for all that can be said, 2021 was a record year for M&A. The global value of M&A transactions is reported to have topped USD 5 trillion for the first time ever, reaching a new record high of over USD 5.8 trillion and exceeding the previous highest year on record, 2018, by almost 50%. The same reports show the global deal numbers have risen as well by 22% in comparison to 2018, reaching a level of approximately 26,000 deals.

> "In line with a trend unbroken in the past five or so years, Germany remained a sellers' market in 2021.

Albeit not being the driver of this trend, Germany was no exception either. In 2021 the total deal value is reported to have slightly exceeded USD 200 billion. According to said reporting the number of deals rose to almost 1,200 while other sources indicate that as much as approximately 2,500 deals were inked in Germany.

Sector Trends: Strong Classics and a Remarkable Second Tier

Quite unequivocally and also confirming the global trend, the TMT sector was the main growth driver in German M&A in 2021, accounting for about a fifth of the total deal value and a bit more than a third of the deal volume. In second place, making up about a quarter of the deal volume in 2021, Germany saw the industrial, manufacturing and automotive sector that traditionally holds a strong position in the country.

What may not be as apparent from the sheer numbers is the continued attractiveness of deals in the consumer markets and health sector, in particular for institutional investors. While these sectors only came in third and fourth in terms of deal volume in 2021 in Germany, interest of institutional investors seems disproportionally high along with increased readiness of Private Equity investors, in particular, to invest in regulated markets. We expect deal-driving consolidation in the business to consumer markets in healthcare in such dissimilar areas as veterinary medicine, human radiology, ophthalmology or dentistry to be a trend to continue.

Another Trend to Continue: Germany Remains a Sellers' Market

In line with a trend unbroken in the past five or so years, Germany remained a sellers' market in 2021, and there are no signs this is going to change sometime soon. The market environment remains competitive for buyers, and sellers' expectations are high. Be prepared to enter a bidders' process when interested in a German target.

Along with the trend of being a sellers' market goes the continued prevalence of locked box deals. Closing accounts have largely disappeared from the scene. As opposed to a closing accounts deal, where the purchase price is ultimately determined based on financial statements drawn up after closing as per the closing date, in a typical locked box deal the purchase price is determined prior to the signing of a deal based on financial statements that have been drawn up in the past, usually as per the most recent preceding financial year end of the target company or group. The legal mechanism to protect the assumptions factored into such a retrospective purchase price determination is to make sure the funds shown in the relevant financial statements have only been used in the target's business and not for payments to the shareholders in whose direction the proverbial "box" shall be locked.

While variations in the scope of locked box mechanisms could be observed until just a few years ago, a firm market standard has now emerged. Locked box mechanisms in Germany today cover a large variety of leakages not only towards the immediate seller but also to affiliated entities and related persons. Typically, tax on leakage is also considered leakage.
The dominance of locked box deals is only half of the truth, though. One may say that the success of the mechanism has become its own worst enemy. The lack of flexibility of the locked box mechanism often coupled with the fact that the financial statements used in relevant deals are set up as per a date more than just a couple of month past at the time of the deal have resulted in a strong market need to soften the archetypical locked box logic. As a result, so-called hybrid locked box mechanisms get used, arguably more often than not.

The goal of these hybrid mechanisms is usually to account for developments in the net asset and/or net working capital situation of a target company or group not (yet) apparent from the locked box financial statements due to their age. In contrast to what could be said about the locked box mechanism itself, no clear picture of the forms of these hybrid mechanisms has emerged so far. They come in a great variety of options usually directly tailored to a specific deal and target. For example, accounts yet to be drawn up or audited get used as locked box financial statements, often in conjunction with a purchase price adjustment mechanism using an equity bridge abbreviated in comparison to what was used in traditional closing accounts deals. Other examples of hybrid mechanisms are guarantees on certain KPIs or balance sheet positions such as equity that result in an indirect purchase price adjustment in the event such guarantees prove incorrect. As with all individually tailored solutions, these hybrid mechanisms must be handled with special care, and deal participants are well advised not to save on the wrong end but to look carefully at these mechanisms together with appropriate counsel.

A Success Story: Demand for W&I Insurances Bound to Exceed Insurers' Capacities

W&I insurances have long gone from a niche solution to a dominant instrument used in a lot of deals in Germany. This type of insurance provides a possibility to reduce or even exclude the liability, typically of sellers, for warranty or indemnity claims by having an insurance cover the relevant claims. While remaining standard in transactions with Private Equity involvement they can now also frequently be seen in other deals.

The W&I insurance market has continuously matured. Lead times to take insurances out are dramatically decreasing while insurance terms require less and less negotiation. It is now feasible to have a W&I insurance ready for signing in less than five business days. Another notable market development is that W&I insurance coverage is becoming increasingly independent from negotiation results reached by the parties to a deal. While knowledge scrapes by which W&I insurers would unqualifiedly insure a warranty that had only been granted under knowledge qualification by the seller have been around for some time already, insurers now increasingly offer materiality scrapes, extensions of the contractually agreed statute of limitations or enhanced damage definitions disregarding limits set out in the agreed transaction documentation. So-called contingent risk insurance, i.e. coverage for known risks, in particular, in the areas of tax, environmental and litigation is also increasingly possible. Outside the tax indemnity which gets synthetically covered based on a buyer's tax due diligence quite frequently already fully synthetic warranty coverage is still rarely seen.

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> As with all individually tailored solutions, these hybrid mechanisms must be handled with special care.

However, on the flipside, market rumors have it that currently the demand is close to, if not already exceeding, market capacity. It remains to be seen how insurers will react. In any event, making contact to insurers respectively insurance brokers early in the transaction process is advisable.

Still in Troubled Waters: Pandemic Related Disruption Remains an Issue

As elsewhere, or maybe even more so, after having continued for more than two years now the COVID-19 pandemic continues to be an issue in Germany. In particular, many supply chains have still not fully recovered from the disruptions they faced as a result of the global repercussions of the disease.

This also affects the legal elements of M&A transactions. A warranty that a target business had been conducted in the ordinary course for a certain period of time usually corresponding to the most recent available financial statements can be considered a firm standard in share purchase agreements in Germany. As a result of the pandemic, such warranty nowadays regularly requires COVID induced qualifications. Pandemic related changes have affected all kinds of businesses in a number of different ways. While some have increased storage levels and developed a correspondingly increased need for funding, others have not been able to produce as usual due to supply chain disruptions or been barred from doing business over considerable periods of time due to COVID related restrictions altogether.

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> We expect to see an increase in post-M&A disputes in the coming years.

Another consequence of the pandemic that may be more widespread in Germany than in some other jurisdictions is that most businesses have benefitted from different forms of public funding. A great many businesses have benefitted from short-time allowances or taken out one or more grants like the many interim allowances the third generation of which is currently available. Terms of such allowances do generally not create issues in transactions.

As a more M&A specific reaction deal participants resort to as a result of the uncertainties created by the pandemic one can observe an increase in deferred purchase price mechanisms such as, in particular, earn-out mechanisms. These mechanisms linking a portion of the purchase price to a certain level of, e.g., revenue, EBIT or EBITDA being sustained or increased over a certain period of time are a way of mitigating the risk of adverse future developments for buyers while keeping deals attractive for sellers. Considering the nature of such elements, we expect to see an increase in post-M&A disputes in the coming years.

A Mixed Picture: The Regulatory Environment

While the dust around the EU’s General Data Protection Directive (GDPR) seems to have settled, anti-money laundering regulations keep tightening with considerable impact on deal implementation in Germany. As a majority of transactions in private M&A in Germany is implemented with the assistance of notaries, notaries are a welcome connecting point for anti-money laundering checks in Germany. Notary offices are forced to run comparably extensive checks on the persons participating in a notarial recording. Against this background, it is generally advisable for deal participants to have their beneficial ownership information ready, in particular, if they are part of more complex fund structures in which control and beneficial ownership do not necessarily follow the simple logic of ownership in voting shares. Deal participants should also make sure their registrations in the German Transparency Register are up to date. Once German real estate (including also property-like items such as hereditary building rights) is involved, having such information ready can become deal critical. Notaries are prohibited from recording a deal involving German real estate unless they have satisfied themselves of the beneficial ownership situation.

On the brighter side of things, regulation is not as strict as it may seem to be. Anti-money laundering information can usually be provided by email and, despite some notaries claiming otherwise, there is generally no requirement to provide declarations signed in wet ink. In addition, forms have developed over the past years and can now be completed rather easily and quickly compared to the lengthy and sometimes somewhat cryptic forms in use a few years ago.

It seems not all market participants are aware that Germany has a foreign direct investment controls regime. The tendency of legislative activity in this area in the past five years clearly points in the direction of increasingly tightening rules with participation thresholds having been lowered on various occasions while the scope of relevant industries keeps getting extended. Still, the overall approach of linking notification and approval requirements to the acquisition of participations in enterprises exceeding certain thresholds in certain specifically identified industries provides for an overall set-up of foreign investment control hardly felt in large parts of the German M&A market. Since only non-EU investors are affected outside the defence sector with the scrutiny of authorities arguably directed more to the geographical east than to the west, the main focus of the foreign direct investment controls regime is likely to predominantly remain on China.

As a bright spot in the regulatory environment, thresholds for German merger control approval requirements were raised not just insignificantly in 2021. While the threshold for global revenues of the companies participating in a merger remained at EUR 500 million, the thresholds for domestic revenues have doubled from EUR 25 million to EUR 50 million and more than tripled from EUR 5 million to EUR 17.5 million so that now one merger participant with domestic revenues in Germany of more than EUR 50 million and another one with domestic revenues in Germany of more than EUR 17.5 million is required. As with the previous EUR 5 million threshold an exception for the EUR 17.5 million requirement applies if the consideration for the merger exceeds EUR 400 million and the target exercises significant domestic activities in Germany.

Do Investors Discover their Social Conscience? ESG Criteria Gain Traction

Environmental, social and governance (ESG) aspects have become increasingly important for institutional investors over the past years. It is not only niche investors with a specific focus on these matters that drive the trend but also prominent household names in the field such as BlackRock and Blackstone that make sustainability criteria an integral part of investment decisions. Specifically targeted ESG due diligence has developed as a new standard form of due diligence undertaken by an increasing number of investors. With the German Act on Entrepreneurial Duties of Care in Supply Chains entering into force on 1 January 2023, it is likely we will see this trend reinforce.

2022 - an Uncertain Outlook after a Record Year in M&A

While optimism for the strong performance in M&A markets seen in 2021 to continue in 2022 may have been dominating at the outset of the year, Putin's damnable invasion of the Ukraine raises question marks on the future development of M&A markets both in Germany and globally. While Private Equity and Venture Capital investors continue to hold ample resources of dry powder, further disruptions to supply chains already stricken by the pandemic, increasing oil and gas prices, higher inflation and a general global economic downturn may also impede M&A activity. However, as uncertain the global outlook for M&A markets may be, it seems unlikely Germany will be an exception to the general trend to emerge. With its solid base of small and medium enterprises, technology leaders and hidden champions, Germany can continue to be expected to provide attractive deal opportunities for a broad range of both domestic and international buyers. Russian deal participants should, however, cease to be market players in the year ahead due to the far-reaching sanctions imposed on the country.

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> As uncertain the global outlook for M&A markets may be, it seems unlikely Germany will be an exception to the general trend to emerge.

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HONG KONG
Staying resilient in an era of growing tax uncertainty

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John has over 25 years of experience in KPMG's tax practices in Hong Kong and New Zealand. John's work involves providing the full range of tax assistance and advice to multinational companies across the Asia Pacific region and beyond. He has extensive experience in cross-border investment structures and financing arrangements, including leading and advising on numerous regional and global engagements.

A number of John's clients use Hong Kong as the location for their head office and John advises these organisations on managing their tax affairs regionally and globally. His role involves advising on issues relevant to the establishment and restructure of investment holding and operating structures for companies operating in diverse industries and countries. John has extensive international merger and acquisition experience and is seasoned in advising clients in a wide variety of industries including financial services.

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Chris has extensive experience in advising on merger and acquisitions and corporate restructuring/ divestment transactions. Chris has led a large number of tax due diligence projects involving the acquisitions of PRC companies in various industry sectors. He has also provided tax structuring and tax compliance assistance on various corporate restructuring/ divestment transactions involving PRC and Hong Kong companies.

In addition, Chris has assisted numerous international and PRC domestic clients, including transaction structuring and devising tax effective strategies for implementing PRC business operations and arrangements, including profit repatriation and investment exit strategies.

Chris is a regular speaker and writer on tax matters and has been interviewed and quoted in the Wall Street Journal and BBC World News. Chris has also provided assistance and conducted research for the China Ministry of Finance and the State Administration of Taxation on a range of tax policy formulation matters including BEPS, Digital Economy, International tax policy development impact on China and GAAR rules.

Over the past two years Hong Kong SAR has faced unprecedented challenges due to the social unrest which have since abated more recently, continuing geopolitical tensions and the Covid-19 pandemic. While Hong Kong's deal activity had a slow start in the beginning of 2021, we saw a rebound in the second half of the year with strong growth in M&A deals and capital inflow into Hong Kong. This is driven by significant amounts of capital being deployed on acquisition opportunities in Mainland China and Hong Kong, indicating that Hong Kong remains a key investment and international financing centre. Despite on-going economic uncertainties, we anticipate this deal momentum to persist and carry well into 2022 as the global economy recovers.

> "There will be significant tax developments in Hong Kong as a result of BEPS 2.0 Pillars 1 and 2 and the EU adding Hong Kong to its "grey-list".

Hong Kong ticks most boxes for global investors. Being one of the world's freest economies, Hong Kong has no restrictions on foreign ownership nor capital and foreign exchange controls over repatriation of profits, interest and investment principal. Hong Kong's simple tax system, robust capital markets, well-developed infrastructure and a business-friendly regulatory environment has also helped drive cross-border activities.

Key developments in the Hong Kong SAR

In the Chief Executive's fifth policy address in October 2021, the Hong Kong SAR Government remains focussed on boosting Hong Kong's position as Asia's premier international finance centre and in recent years, various regulatory and tax reforms have been introduced. This has helped reaffirm Hong Kong's status as international asset and wealth management centre and an important gateway to Mainland China and the region.

The introduction of the Limited Partnership Fund (LPF) regime gives asset managers a real viable alternative to the traditional offshore fund vehicles used by Asian managers. In line with the global trend in bringing vehicles onshore, the LPF is a very flexible onshore vehicle that can be used by sponsors to raise and pool capital. Further, the Unified Funds Exemption regime in Hong Kong allows eligible LPF to remain tax-exempt in Hong Kong, which is an important consideration for Hong Kong to become a global funds centre.

There have also been amendments to the existing Open-ended Fund Company (OFC) regime, which make the OFC regime an extremely competitive choice for an open-ended corporate fund vehicle. The restriction on assets that an OFC is permitted to invest has been relaxed, and an OFC is tax exempt if the Unified Funds Exemption applies.

To enhance the attractiveness of the LPF and OFC regimes, the recently announced re-domiciliation measures have helped attract non-Hong Kong funds to relocate to Hong Kong. This is bolstered by the introduction of a 0% concessional tax treatment for Carried Interest paid from a fund. This incentive is a first in Asia and is designed to attract further private equity and other private fund managers to Hong Kong.

In the coming year or two, there will be significant tax developments in Hong Kong as a result of BEPS 2.0 Pillars 1 and 2 and the EU adding Hong Kong to its "grey-list". Conducting cross-border transactions in or via Hong Kong will need to be structured carefully in a rapidly evolving tax landscape and without proper tax planning, there can be unintended consequences and unexpected costs that would impact adversely on investment returns. This article highlights some key areas and trends that we are seeing for prospective acquirers and existing investors while flagging some practical considerations from a Hong Kong tax perspective.

Key Hong Kong tax considerations

Hong Kong operates a territorial sourced-based system of taxation whereby only Hong Kong sourced profits derived by a company carrying on a business in Hong Kong are taxable. Capital gains are not taxed in Hong Kong, and there is no value added tax or other indirect taxes on goods and services.

Potential acquisition structures
Share deal

In Hong Kong, M&A deals are typically structured either as a share deal or an asset deal. Share deals are generally more common for an acquisition instead of an asset deal. Under a share deal, all of the target's historical tax attributes are preserved and passed on to the acquirer.

Investors looking to invest in Hong Kong would typically incorporate an offshore SPV either in the BVI or the Cayman Islands as an investment holding platform to acquire the Hong Kong target company(s). This holding structure also provides the flexibility for investors to exit at the offshore SPV level given there are no indirect transfer rules in Hong Kong and Hong Kong does not impose tax on capital gains. That said, with the introduction of Economic Substance Laws in tax neutral jurisdictions, it is crucial that sufficient economic substance is maintained in the offshore SPV together with appropriate documentary evidence to demonstrate that the relevant gain is offshore sourced and thus outside the scope of Hong Kong tax.

Given Hong Kong is an important gateway to China and a vital part of the Greater Bay Area, investors investing into Mainland China will often structure the deal using an offshore SPV – Hong Kong holding structure to acquire China target group companies. The advantages of adopting such a structure are that future repatriation of dividends and shareholder loan interest paid from the China target company could qualify for withholding tax rate reduction from the general China withholding tax rate of 10% to 5% under Hong Kong's Double Tax Arrangement (DTA) with Mainland China, where the Hong Kong acquirer qualifies as a Hong Kong tax resident and the requisite DTA conditions are satisfied. Moreover, this structure will also provide investors with the flexibility to exit at the offshore SPV level. However, a disposal at the Hong Kong SPV level would trigger Hong Kong stamp duty at 0.26% of the higher of the market value or the consideration paid payable by both the acquirer and seller. There are also China indirect transfer rules to consider given that the underlying China target is indirectly disposed of in that case and reasonable business purposes need to be demonstrated to avert the Chinese tax authorities seeking to recharacterize the transaction leading to 10% capital gains tax being imposed.

Sellers could exit their investment at the offshore SPV level and treat the relevant gain as offshore sourced.

Asset deal

Under an asset deal, the acquirer can cherry-pick specific assets and/or liabilities of the target companies. Acquirers would typically pursue an asset deal where there are significant historical tax liabilities or non-tax liabilities that the acquirer may not want to inherit. It is common for the assets to be transferred to a Hong Kong acquisition company. The Hong Kong acquisition company would typically be liable for all taxes arising from the transferring company unless a notice of transfer is published in the Government Gazette and newspaper in Hong Kong within a specified period.

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Asset deals are generally less attractive for sellers given the sale of depreciable assets could potentially lead to a recapture of capital allowances as well as triggering stamp duty depending on the assets involved. The acquirer should ensure that the sale and purchase agreement (SPA) specifies a commercially justifiable allocation of the purchase price to the target assets acquired and assumed liabilities. The acquirer may achieve a step-up in the cost basis to fair market value which increases the amount of future tax deductions from these assets. This could also potentially reduce any gains derived by the acquirer from a future sale of the business. However, any tax losses of the selling entity will not be transferred to the acquirer and such losses can be used to offset against any gains derived from the sale of the business / assets.

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There has been an increase in earnout provisions in M&A deals which is not uncommon during times of uncertainties.

Tax losses

Appropriate tax planning should also be considered where loss-making companies are acquired given there are specific rules which may restrict the amount of carry-forward losses upon a change of ownership of a loss-making company. A sale of the shares in a Hong Kong company would not affect the availability of losses to be carried forward to the acquirer unless the sole purpose of the ownership change was to utilise the tax losses. There is no group relief in Hong Kong and tax losses can be carried forward indefinitely to offset against future assessable profits.

Under an asset deal, any unused tax losses incurred by the seller company cannot be transferred to the acquirer. However, such losses can be used to offset against any gains derived from the sale of the business / assets by the seller.

Acquisition financing

In Hong Kong, M&A transactions can be financed through debt and/or equity. Hong Kong does not impose any withholding tax on dividends nor interest paid to non-residents. Given there are no thin capitalisation rules in Hong Kong, there are no limits on the level on debt funding. However, Hong Kong has very strict interest deduction rules. Generally, interest and financing costs incurred on money borrowed to finance the acquisition of shares are not deductible for Hong Kong tax purposes. Given Hong Kong has a relatively low profits tax rate of 16.5%, a tax deduction may be available at higher rates in other jurisdictions. However, the acquirer could claim tax deductions on the interest incurred on funds borrowed to finance the asset acquisition.

There is also scope to achieve debt pushdown by borrowing to replace equity funding with debt funding (e.g. by paying a dividend), where the equity is employed as capital or working capital in a business carried on for the purpose of earning assessable profits.

Contractual protection

SPAs in Hong Kong are generally shorter than their international counterparts. In Hong Kong, tax indemnities and/or warranties are commonly used in Hong Kong subject to negotiation between the parties and due diligence procedures being carried out to identify any potential tax liabilities and tax costs.

However, in light of the economic uncertainties, we are seeing companies adopt alternative approaches in deal making. Particularly, there has been an increase in earnout provisions in M&A deals which is not uncommon during times of uncertainty. Structuring an M&A transaction with earnout provisions is typically used to bridge valuation gaps between the parties and can provide acquirers some protection in the event that the target does achieve certain financial targets. That said, earn out provisions also compensate sellers when performance and/or financial targets are met.

Post-acquisition structuring

C-suite are demanding greater value from M&A transactions and it is becoming important to identify opportunities that will generate cash tax in the future post acquisition. Depending on the complexity of the target group's holding structure, post-acquisition restructuring and undertaking legal entity rationalisation exercise is becoming a norm in the market to unlock business synergies and improve the group's efficiency from a tax perspective.

One of the major tax considerations is whether there are transfer taxes. Effective from 1 August 2021, transfer of shares in Hong Kong companies are subject to stamp duty payable at 0.26% on the higher of the consideration or market value of the shares. There is intragroup relief for transfers where a 90% common ownership threshold applies provided conditions for the relief are met. Where there is a transfer of commercial immovable properties, Hong Kong stamp duty is payable at a maximum rate of 4.25% depending on the value.

Hong Kong has also introduced court-free amalgamation regime which allows for: (i) horizontal amalgamation between a company and its wholly-owned subsidiaries; or (ii) vertical amalgamations of a parent company and its wholly-owned companies. Depending on the target group structure, certain tax attributes of the amalgamating company are allowed to be carried over to the amalgamated company (such as tax losses and tax concession elections) provided certain conditions and anti-avoidance measures are met.

Future developments
BEPS 2.0 and the EU's tax "grey-list"

Like many jurisdictions in the Asia Pacific region, Hong Kong will embark on substantial tax reform initiatives as a result of BEPS Pillar 1 and Pillar 2 and it being added to the EU's tax "grey-list". Following a review of foreign sourced income exemption regimes conducted by the EU, Hong Kong has agreed to make changes to its tax law to address the EU's concerns on double non-taxation of passive income (e.g. interest and royalties) in certain circumstances.

In the Hong Kong Budget 2022/23, the HKSAR Government announced that it is looking to introduce a tax bill within 2022 to implement the OECD's global minimum tax rate for large multinational enterprise groups with global turnover of at least EUR750 million. This will include the introduction of a domestic minimum top-up tax for these groups from the year of assessment 2024/25.

While BEPS Pillar 2 only impact those large multinational companies that fall within a certain threshold, the impact of the EU "grey-list" will affect all corporate taxpayers. It will be crucial for acquirers to adequately assess and model the impact of these changes as part of their due diligence on potential targets.

Environmental, Social and Governance ("ESG")

There is also a global shift towards ESG and ESG factors are now becoming a value driver in M&A transactions. Investors are increasingly incorporating ESG into their investment decision-making process and companies that fail to address and understand key ESG risks in their business could potentially impact a company's value and, in some cases, be a potential deal-breaker.

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> There is a global shift towards ESG and ESG factors are now becoming a value driver in M&A transactions.

Regulators in Hong Kong are stepping up their efforts in pushing forward the ESG agenda by introducing various regulatory disclosure requirements. There will be growing pressure for investors to understand whether a target has a good tax governance framework and may benchmark its performance against ESG metrics. We will likely see a growing trend of acquirers incorporating ESG factors into their pre-investment due diligence procedures.

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At KPMG, we provide seamless and integrated solutions for our clients to capture opportunities.

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HONG KONG

Overview of Hong Kong's new SPAC regime and recent development of take-private transactions of companies listed in Hong Kong by way of a scheme of arrangement

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Mergers and acquisitions involving Hong Kong-based companies in 2021 showed an increase in value as compared to 2020. One of the driving forces was mergers of a number of Hong Kong start-ups with "special purpose acquisition companies" (or **SPAC**s for short, a type of blank-cheque companies) listed in the United States.

During the first quarter of 2022, mergers and acquisitions activity in Hong Kong declined due to economic uncertainties and geopolitical risks amid the ongoing COVID-19 pandemic and the Russia-Ukraine conflict. However, it is expected that the new SPAC regime introduced by the local bourse could bring momentum to mergers and acquisitions activity in Hong Kong towards the end of 2022 and beyond.

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> A SPAC is a shell company that raises funds through an initial public offering (IPO)

The first part of this article gives an overview of Hong Kong's new SPAC regime, with a focus on SPAC mergers. The second part discusses the recent development of take-private transactions of companies listed in Hong Kong by way of a scheme of arrangement.

New SPAC regime

A SPAC is a shell company that raises funds through an initial public offering (**IPO**), which are then held in an escrow/trust account, pending a business combination (**De-SPAC Transaction**) with a private operating company (**De-SPAC Target**) within a pre-defined time period after listing (typically two years for SPACs listed in the United States). The listed issuer resulting from the completion of a De-SPAC Transaction is a **Successor Company**. SPACs are formed by **SPAC Promoters** (known as "sponsors" in the United States), who are typically professional managers who have private equity, corporate finance and/or relevant industry experience. If the SPAC fails to complete a De-SPAC Transaction within the pre-defined time period, it must either seek approval from SPAC shareholders for an extension of the life of the SPAC, or else liquidate. If a SPAC is liquidated, SPAC shareholders will receive a pro rata amount of the funds held in the SPAC's escrow/trust account. SPAC Promoters bear all the expenses for establishing and maintaining a SPAC, which would not be recoverable if the SPAC fails to complete a De-SPAC Transaction.

SPACs have been around for decades as an alternative to traditional IPOs in the United States, but SPAC listings dramatically surged in 2020 and reached a record high in 2021. This in turn has driven an increase in M&A activities globally as SPACs are competing to merge with De-SPAC Targets before the deadlines.

In mid-December 2021, in order to attract Greater China and South East Asia companies to list in Hong Kong that may otherwise choose to list elsewhere via De-SPAC Transactions, The Stock Exchange of Hong Kong Limited (**SEHK**) announced new rules to create a new SPAC listing regime in Hong Kong, which took effect on 1 January 2022. Instead of replicating the regimes of the United States or other major markets, the Hong Kong regime is tailored to address the particular risks and requirements of our market, and is more stringent than other markets in a number of ways. For instance, the subscription and trading of a SPAC's securities are restricted to "Professional Investors" (as defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance); and a SPAC must, at listing and on an ongoing basis for the lifetime of the SPAC, have at least one SPAC Promoter which is a firm that holds a Type 6 (advising on corporate finance) and/or a Type 9 (asset management) licence issued by the Securities and Futures Commission of Hong Kong. There are no such restrictions or requirements in the SPAC regimes of other major markets.

By the end of April 2022, 12 SPACs had lodged listing applications, with the first one listed on 18 March 2022. The SPAC Promoters of these cases include state-owned financial institutions, HK-listed companies, private equity funds and well-known entrepreneurs. The target business sectors range from "new economy", healthcare, consumer lifestyle and TMT to smart car technologies.

The market expects to see a strong pipeline of SPAC listings in Hong Kong in 2022, consequently further pushing up M&A activities, particularly in the Greater China region which naturally is the most popular geographical focus of Hong Kong SPACs.

Set out below are some salient points of the rules governing De-SPAC Transactions under the Hong Kong SPAC regime:

Eligibility of De-SPAC Targets

- New listing requirements – The Exchange will consider a De-SPAC Transaction in the same way as a reverse takeover (i.e. a deemed new listing), which means that the Successor Company resulting from completion of the De-SPAC Transaction must meet all new listing requirements (including, among others, minimum market capitalisation requirements and financial eligibility tests under the Rules Governing the Listing of Securities on the SEHK (**Listing Rules**)).

- Type – Except for an investment company (as defined by Chapter 21 of the Listing Rules) which the Exchange would not consider to be an eligible De-SPAC Target, there are no restrictions imposed on the types of De-SPAC Targets. Pre-revenue biotech companies and mineral companies as well as companies with weighted voting rights structures would be eligible De-SPAC Targets so long as they meet all applicable new listing requirements of the Listing Rules.

- Size - A De-SPAC Target must have a fair market value of at least 80% of funds raised by the SPAC from its initial offering.

Mandatory independent third party investments

- A SPAC must obtain funds from outside independent third party investors for the purpose of completing a De-SPAC Transaction.

- The total funds to be raised from the independent third party investors (which must be Professional Investors) must constitute at least a certain percentage of the negotiated value of the De-SPAC Target:

Negotiated value of the De-SPAC Target ("A")	Minimum independent third party investment as a percentage of (A)
< HK$2 billion	25%
HK$2 billion - < HK$5 billion	15%
HK$5 billion - < HK$7 billion	10%
≥ HK$7 billion	7.5%
> HK$10 billion	< 7.5%

The investments made by the independent third party investors must result in their beneficial ownership of listed shares in the Successor Company.

- At least 50% of the value of the independent third party investment should be contributed by no fewer than three investors of a certain type - either an asset management firm with assets under management of at least HK$8,000,000,000 or a fund with a fund size of at least HK$8,000,000,000.

> "The market expects to see a strong pipeline of SPAC listings in Hong Kong in 2022, consequently further pushing up M&A activities.

Shareholders' approval

- A De-SPAC Transaction must be made conditional on approval by the SPAC's shareholders at a general meeting. SPAC Promoters and their close associates must abstain from voting.

Deadlines for announcing and completing a De-SPAC Transaction

- A SPAC must:
  - publish an announcement of a De-SPAC Transaction within 24 months of the date of its listing; and
  - complete a De-SPAC Transaction within 36 months of the date of its listing.

- The SEHK may permit an extension of either deadline for a period of up to six months if the extension is approved by an ordinary resolution of the SPAC's shareholders at a general meeting (on which the SPAC Promoters and their respective close associates must abstain from voting).

- If the SPAC misses either deadline, the SEHK may suspend the trading of the SPAC, which must, within one month, return the funds it raised at its initial offering to the SPAC shareholders as held in the escrow account on a pro rata basis. Upon the return of funds, the SEHK will cancel the listing of the SPAC's securities.

Take-private transactions

There was a very significant increase in the number of deals involving the taking private of companies listed in Hong Kong in 2020 (37 deals announced), as compared to 2019 (12 deals announced). Despite a slight drop, take-private activities remained at a high level in 2021 (32 deals announced).

Scheme of arrangement – the most common method

For many years, a majority of take-private deals involving companies listed in Hong Kong have been effected by way of a scheme of arrangement. This is a statutory procedure involving court-sanctioned arrangement between a company and its shareholders, available under the laws of certain jurisdictions, including Bermuda, Cayman Islands and Hong Kong, which are common places of incorporation of companies listed in Hong Kong. A scheme of arrangement for taking private a company essentially involves the cancellation of all the issued shares of the company (other than those held by the offeror) in return for a cash or non-cash consideration paid by the offeror, followed by the issue of new shares to the offeror, resulting in the offeror holding a 100% interest in the company. This is a common method for a controlling shareholder seeking to privatise the company. There were also a handful of "friendly" deals (as opposed to "hostile" deals, which are not common in Hong Kong given the prevalence of listed companies with controlling shareholders) where an outsider (i.e. not being an existing shareholder) acquired a 100% interest in a company by way of a scheme of arrangement.

The Hong Kong Code on Takeovers and Mergers (**Takeovers Code**), which is the major set of non-statutory rules governing takeovers and mergers affecting Hong Kong listed companies, requires that a scheme of arrangement may only be implemented if, in addition to satisfying any voting requirements imposed by law: (a) the scheme is approved by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at a duly convened meeting of the holders of the disinterested shares; and (b) the number of votes cast against the resolution to approve the scheme or the capital reorganisation at such meeting is not more than 10% of the votes attaching to all disinterested shares. The Hong Kong Companies Ordinance imposes the same voting requirements for listed companies incorporated in Hong Kong, except that the scope of "disinterested shareholders" may not always exactly overlap with that provided in the Takeovers Code. The respective Companies Acts of the Cayman Islands and Bermuda, in addition to the "75%" in value approval requirement, also require a scheme to be approved by a "majority in number" of the scheme shareholders present and voting in person or by proxy at the relevant shareholders' meeting ordered by the court. This is the so-called "headcount test", which was also in the Hong Kong Companies Ordinance prior to March 2014, but was then abolished.

> "There was a very significant increase in the number of deals involving the taking private of companies listed in Hong Kong in 2020

The "headcount test" hurdle

Most of the shares of Hong Kong listed companies are held within the Central Clearing and Settlement System (**CCASS**) in the name of a "single member" as a central depositary (i.e. HKSCC Nominees Limited (**HKSCC Nominees**)) for trading purposes. A Hong Kong listed company incorporated in the Cayman Islands or Bermuda proposing a take-private scheme would inevitably need to seek the Court's direction to ascertain the treatment of this "single member" for the purpose of the headcount test. The approach adopted by the Courts however has not been entirely consistent throughout the years. We note the following different treatments in cases involving Cayman Islands take-private schemes in recent years: (i) HKSCC Nominees was permitted to vote once for and once against the scheme in accordance with the instructions received by it from CCASS participants; (ii) HKSCC Nominees was counted as one shareholder and whether the vote of HKSCC Nominees was counted in favour of or against the scheme was determined by the majority of voting instructions received by it from CCASS participants; and (iii) HKSCC Nominees was treated as casting one vote for each CCASS participant that instructed HKSCC Nominees to vote for the scheme and one vote for each CCASS participant that instructed HKSCC Nominees to vote against the scheme. For Bermuda take-private schemes, the "one-headed" approach (i.e. (ii)) seems to be the prevailing one.

A number of privatisation schemes failed on the headcount test despite fulfilling the voting requirements under the Takeovers Code (e.g. the Cayman Islands-incorporated companies, Glorious Property Holdings Limited and New World China Land Limited). Under the Takeovers Code, in cases of unsuccessful privatisation offers, the offeror will normally be precluded from buying any shares in the offeree company within 12 months of the offer lapsing if the result would be that the listing of the offeree company's shares on the SEHK would be discontinued. In the case of New World China Land Limited, after the privatisation plan failed in 2014, it was successfully privatised in 2016 as the offeror avoided the headcount test hurdle and, instead of a scheme of arrangement, pursued the privatisation plan by launching a voluntary general offer which was conditional upon achieving a 90% acceptance level, which is the threshold allowing the offeror to exercise the compulsory acquisition rights available under the Caymans Islands Companies Act to compel the shareholders who have not accepted the offer to sell the remaining shares to it. Under the Takeovers Code, compulsory acquisition rights may only be exercised if, in addition to satisfying any requirements imposed by law, acceptances of the offer and purchases made by the offeror and its concert parties during the period of four months after posting the initial offer document total not less than 90% of the disinterested shares.

Anticipated abolition of the headcount test in Cayman Islands take-private schemes

> "A number of privatisation schemes failed on the headcount test despite fulfilling the voting requirements under the Takeovers Code

In late Oct 2021, the Companies (Amendment) Bill 2021 was gazetted in the Cayman Islands. One of the proposed amendments is to abolish the headcount test for a scheme of arrangement between a company and its shareholders. The market is expecting this welcome reform to come into effect in the second quarter of 2022. There will then be one less hurdle for Cayman Islands companies listed in Hong Kong to be taken private by way of a scheme of arrangement.

JAPAN
"Latest trends – M&A in Japan"

ANDERSON MORI & TOMOTSUNE

BIO

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He is a graduate of University of Tokyo (LL.B. 2007), the University of Tokyo School of Law (J.D. 2009), and Columbia School of Law (LL.M. 2016, Harlan Fiske Stone Scholar). He was admitted to the Japan bar in 2010 and New York bar in 2017. He also worked at Ashurst in Sydney from 2016 to 2017.

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Overall Trends – M&A in 2021

M&A activity in Japan was off to a steady start in 2021. While the coronavirus pandemic and emergence of variants has continued to affect M&A activities in Japan, there was a rebound in deal-making activities in 2021, during which time the Japanese M&A deal value exceeded approximately USD140 bn across more than 4,000 transactions, the highest annual volume on record and equivalent to a 1.14x uptick in volume in 2020, with at least 20 M&A deals valued at over USD1 bn in 2021 in Japan.

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> Japanese conglomerates are to continue divesting non-core businesses that are no longer matching their future business strategy

The figures on volume and value do not tell the whole story regarding the latest underlying trends. Thus, while the figures of M&A activity in Japan in 2021 were historically robust, at the same time, 2021 revealed the following, multi-faceted, features as well.

Continued Trend - Non-core Divestitures, and a New Trend – Reshaping of Portfolios

The number of non-core divestitures of sectors that are no longer in accord with their future business has been maintained at a high level, acting as catalysts in particular for private equity fund activities, especially for actors who have been seeking opportunities for Japanese traditional companies to divest non-core assets due to, among other reasons, the negative financial impact suffered as a result of the coronavirus situation. This continued trend is inextricably linked to a new trend where the Japanese traditional companies are taking steps to reshape their portfolios by acquiring new technology to secure a competitive edge at a time of "digitisation", accelerated by coronavirus pandemic over the world.

Non-core Divestitures - Inbound Deals - Global PE Fund

Japanese conglomerates are to continue divesting non-core businesses that are no longer matching their future business strategy due to, among other reasons, the negative financial impact suffered by these conglomerates as a result of the coronavirus situation. The number of so-called "carve-out deals", in which Japanese listed companies carve out subsidiaries or business units and sell them to private equity funds or others, was 409 in 2021 in Japan, up 2.8% from 2020. The total value of such activities was approximately USD 43.3 bn, maintaining a very high level.

As examples of this type of activity it might be helpful to consider a series of non-core divestitures by Hitachi, Ltd. (TSE: 6501, "Hitachi"), a Japanese traditional electrical equipment company. Hitachi has continued to sell its original businesses – Hitachi Koki Co., Ltd., an electric tool manufacturer, to KKR for approximately USD 1.7bn in 2017; Hitachi Kokusai Electric Inc., a communications equipment company, to KKR for approximately USD 2.5bn in 2017; Hitachi Metals, Ltd., an iron and steel mills company, to a consortium led by Bain Capital, for approximately USD 33.0 bn in 2021. Hitachi also announced the sale of shares in Hitachi Construction Machinery Co. Ltd, a manufacturer of construction material handling machinery, to a consortium led by Japan Industrial Partners Inc., a Japan private equity firm, and Itochu Corp, the global general trading firm. These transactions are viewed as carve-out transactions of non-core businesses of Hitachi in order to shift its strategy to IoT and engineering solutions.

Non-core divestitures generate interest in particular for foreign private equity funds, who have been looking for opportunities as Japanese traditional companies divest non-core assets, and the number of global private equity fund buyouts has remained steady. The continued trend here was mainly led by global private equity funds. Examples worth mentioning in this context are Blackstone's acquisition of Takeda Consumer Healthcare Company Limited., a pharmaceutical company in 2021; Bain Capital's acquisition Nichiigakkann Co., Ltd., a medical services company in 2020; Carlyle's management buy-out of Rigaku Corporation, a testing equipment maker in 2021; and KKR's acquisition of Yayoi Co., a financial and accounting software provider, the value of which exceeded USD 1bn and which was the biggest deal among private equity fund buyouts in 2021.

Investments by private equity funds are expected to continue to be a familiar theme in 2022 - a trend that will continue to benefit from the decision of some Japanese conglomerates to divest their non-core assets, in the same spirit of the series of Hitachi deals referred to above.

New Trend – Reshaping of Portfolios

Despite the cautious approach taken in the midst of corona pandemic adopted by Japanese traditional companies in 2020, there was a recovery in appetite for the execution of mega out-bound deals in 2021, representing approximately USD 60.0bn across more than 600 deals in 2021, equivalent to a 1.12x uptick in volume and 1.59x uptick in value from 2020.

While many of these outbound deals continued to aim at expanding the variety of company product or service offerings or geographic reach, there has been a new trend – that of Japanese companies facing business model disruption and shrinking domestic markets, which are compelling them to take steps to reshape their portfolios by acquiring new technology to secure a competitive edge at a time when "digitisation" is being accelerated by the corona pandemic through the world.
As an example of this trend: outbound deal aimed at acquiring new portfolios – Hitachi's acquisition of GlobalLogic Inc. ("GlobalLogic"), a US-based firm providing digital engineering solutions, at approximately USD 8.9bn, was Japan's largest outbound deal in 2021. This deal was aimed at enabling Hitachi Group to accelerate the digital transformation of its social infrastructure on a global scale by expanding its digital solutions business, as well as by promoting its social innovation through digital technology.

Another example of this trend was the divestiture by Shiseido Company Limited ("Shiseido") of its personal care business to a global private equity fund. This was not an out-bound deal but an in-bound deal with features of a non-core divestiture aimed at bringing about a new portfolio strategy. In 2020, Shiseido group was affected by the uncertain and challenging business environment caused by the spread of the coronavirus. Under these circumstances, they have positioned "premium skin beauty" as their core business and, at the same time, it has decided to spin-off its "personal care business", which has a long history dating back to the establishment of Shiseido in 1959, and over the course of 60 years it has been an incubator for the Shiseido brand. Upon the completion of the sale, the "personal care business" will managed by a company financed by funds advised by CVC Asia Pacific Limited and its affiliates, and Shiseido will provide, as a minority shareholder to the company, cooperation aimed at further growth and development of the business.

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> Investments by private equity funds are expected to continue to be a familiar theme in 2022

Domestic deals for Start-up Finance

Japan's start-up space was also heated up during 2021. The amount of funds raised by Japanese startups in 2021 approached approximately USD 8.6 bn, the highest annual volume on record, equivalent to approximately 1.5x uptick in 2021. In particular, the number of foreign investors, including private equity funds, providing large-scale funding for later-stage start-up companies continued to increase in 2021.

To provide an example, Spiber Inc. ("Spiber"), a start-up in its later stages and developer of synthetic protein materials, secured funding worth USD 312.6m, from Carlyle, a cornerstone investor, from Fidelity, from Baillie Gifford and from the Cool Japan Fund, a Japanese fund. As a new investor, Carlyle has made a significant investment into Spiber, representing Carlyle's first-ever non-buyout growth investment in Japan, and as a result Spiber will be able to fully leverage Carlyle's global industry experience, its sustainability expertise, its network of luxury brands, as well as its textile and material industries, to accelerate its further growth.

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> The amount of funds raised by Japanese startups in 2021 approached approximately 8.6bn USD

Further, large scale EXITs by startups through the sale of shares or businesses rather than through IPOs has become an increasingly attractive course of action, as was demonstrated by PayPal Holdings' (NASDAX: PYPL) acquisition of Paidy, a start-up providing a two-sided payment platform and provider of "buy now, pay later" solutions in Japan, for approximately USD 2.7bn.

Currently, the Tokyo Stock Exchange has four market divisions - 1st Section, 2nd Section, Mothers, and JASDAQ, which are subject to a restructuring as three new markets in April, 2022. For a long time, there have only been a limited number of financing sources for significant growth capital at the later stages of start-ups on the Japanese market, which forced them to choose to go public on Mothers, the "world's easiest" stock exchange to list on when their market capitalisation was still in the low range (under approximately USD 1 bn). However, as these companies achieving a small-IPO without large-institutional investor or corporate venture capitals are mainly invested by small individual investors, they would then face challenges in achieving sustainable growth after their IPO. The new trends above - large-scale funding by foreign entities especially at later stage of start-ups, could be a solution to resolve this issue faced by Japan's start-ups that will contribute to their opportunities for continuous growth after an IPO.

Outlook for 2022

The global market and Japan may continue to take a cautious approach, especially with relation to cross-border deals, due to continued uncertainty surrounding the emergence of coronavirus variants. However, the growth of global private equity investments in Japan is expected to continue to be a constant theme in 2022, with continued large volumes of inbound investments stimulated by both conglomerate divestitures and by start-ups, and Japanese conglomerates will continue to seek acquisitions both at home and abroad while accelerating a review of their non-core businesses.