

Article

Cyprus's IP Box Regime

Authors: Thomas Keane, Christina Vgenopoulou & Loukiana Protopapa

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Introduction

Intellectual Property (hereinafter referred to as “IP”) is a term that includes a wide range of intangible creations of the human mind. Such creations can vary and cover, inter alia, software programs, algorithms and formulas, inventions, trade secrets and know-how, manufacturing or marketing practices, artistic or literary works, designs, images or names.

Over the years, countries have developed corporate tax schemes or regimes incentivizing countries to invest in research and development surrounding IP. In 2012, Cyprus developed its own IP Box Regime which intended to create tax advantages and overall beneficial financial incentives, while offering maximum protection to companies.

IP is undoubtedly a vital asset for any organisation and selecting the location with the most beneficial IP tax regime is a decision not to be lightly taken by businesses. The advantageous tax regime, strategic location, and compatibility of the country’s IP framework with the international benchmark, are some of the reasons that make Cyprus a renowned location for the establishment, development and centralization of IP.

Robust Legal Framework

Cyprus is continuously working towards maintaining and ensuring compliance of its national IP tax regime with international standards, including compliance with the high-level IP framework set by the EU and WIPO¹. In 2016, the Parliament of Cyprus approved the proposed amendments² to the Income Tax Law³ aligning the country’s intellectual property legislation with Action 5 of the Base Erosion and Profit Shifting (the “BEPS”) project of the OECD⁴. Moreover, further amendments have taken place in August, 2020⁵, boosting the attractiveness of the regime by abolishing any tax on the gain realized on the disposal of the intangible assets (even on the capital allowances claimed as tax deduction) and by providing flexibility to taxpayers on the claim of capital allowances over the useful life of the intangible asset.

Similarly, being an EU Member means that Cyprus is afforded a network of protection and support not only by fellow EU Member States but by the signatories of all major IP treaties and protocols within the EU and globally. Notably, Cyprus is a signatory of the following:

- ✓ World Intellectual Property Organisation (WIPO) WIPO Performance and Phonograms Treaty
- ✓ Madrid Agreement Concerning the International Registration of Marks (the Madrid Agreement) and Protocol to the Madrid Agreement
- ✓ Patent Cooperation Treaty
- ✓ Berne Convention for the Protection of Literary and Artistic Works
- ✓ Paris Convention for the Protection of Industrial Property
- ✓ Convention for the Protection of Producers of Phonograms Against Unauthorised Duplication of Their Phonograms

¹ World Intellectual Property Organization

² Law 110(I)/2016 amending the Income Tax Law of 2002

³ Income Tax Law, L.118(I)/2002

⁴ Organisation for Economic Co-Operation and Development

⁵ Law 95(I)/2020 amending the Income Tax Law of 2002

- ✓ Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations

Main Advantages of the Cyprus IP tax regime

The main aspect of the regime is that 80% of the profits qualifying for the regime are exempt from tax. This means that only the 20% of IP income is taxed at a corporate tax rate of 12.5%. Therefore, Cyprus-resident companies can essentially benefit from an effective tax rate of as low as 2.5%.

Other benefits include:

- 80% deduction of profits on disposal of IP rights
- a 5-year amortization period which means that capital expenditure related to IP acquisition of development may be deducted in the first tax year in which the expense was incurred as well as in the subsequent 4 years. This in practice can lower the effective tax rate to less than 2%
- 0% tax on capital nature transactions - if the disposal of intangible assets is a capital nature transaction, then the resulting capital gain will not be taxable.

Important Definitions:

Qualifying Assets

The IP regime adopts the 'nexus approach', whereby for an intangible asset to qualify for the benefits of the regime, there needs to be a direct link between the qualifying income and the own qualifying expenses contributing to that income. Thus, in order for a significant proportion of IP income to qualify for benefits, a significant proportion of the actual research and development (R&D) activities must have been undertaken by the qualifying taxpayer itself.

Under the Income Tax Law, a "qualifying intangible asset" is defined as an asset which was acquired, developed or exploited by a person within the course of carrying out his business (with the exception of intellectual property related to marketing), which is the result of R&D activities, and which includes intangible assets for which only economic ownership exists.

The IP tax regime comprises a variety of intangible assets including:

- Patents;
- Computer software, and
- Other IP assets which are non-obvious, useful and novel.

Business names (including brands), trademarks, image rights and other intellectual property rights used to market products and services are not considered as qualifying intangible assets.

Qualifying Profit

Qualifying profits (QP) means the proportion of the overall income (OI) corresponding to the fraction of the qualifying expenditure (QE) plus the uplift expenditure (UE) over the overall expenditure (OE) incurred for the qualifying intangible asset. The amount of qualifying profit can be derived by applying the below formula:

$$QP = OI \times \frac{QE + UE}{OE}$$

OE

Overall Income

Overall income arising from the qualifying intangible asset means the gross income accrued within the tax year, less the direct costs for generating such income.

The overall income includes, but is not limited to the following:

- Royalties or other amounts in connection with the use of qualifying intangible asset.
- Any amount for a license for the operation of qualifying intangible asset.
- Any amount received from insurance or as compensation in relation to the qualifying intangible asset.
- Capital gains and other income from the sale of qualifying intangible asset.
- Embedded income of qualifying intangible asset arising from the sale of products or by using procedures that are directly related to this item.

Qualifying Expenditure

Qualifying expenditure can include salary/wages, direct costs, general expenditure linked to R&D activities, and R&D expenditure from independent sources. It does not, however, include any expenses of IP acquisition, paid or payable interest, any costs payable to related persons handling R&D, and costs that cannot prove a direct link with specific qualifying assets.

Uplift Expenditure

The uplift expenditure (UE) is the lower of:

- 30% of the QE and
- The total acquisition cost of the QA and any R&D costs outsourced to related parties.

Overall Expenditure

It is the sum of:

- The qualifying expenditure and
- The total acquisition costs of the QA and any R&D costs outsourced to related parties incurred in any tax year.

Disposal of an IP asset

Following the amendment of the Income Tax Law in 2020, IP asset disposals that are deemed a capital nature transaction, are tax exempt in Cyprus. However, if considered as a trading nature transaction, then the accounting gain/loss will be taxable. Furthermore, up to December 2019, the disposal of an IP asset would trigger the obligation to prepare a balancing statement. As of January 2020, however, the obligation to prepare a balancing statement has been abolished.

Deductions for Non-Qualifying Intangible Assets

Income arising from non-qualifying intangible assets, can still benefit from certain provisions of the Cyprus tax law thus reducing the overall effective tax rate of the company.

Expenditure for the acquisition of a non-qualifying intangible asset and which asset is used in furtherance of the business, can be amortized over the asset's useful life with a maximum period of 20 years. Goodwill, however, does not qualify for amortization.

Organisations have the option not to claim capital allowances in a given year. Moreover, capital allowances that have not been claimed in a year are claimed over the remaining useful life of the asset.

Notional Interest Deduction may also be available on certain non-qualifying intangible assets.

Conclusion

Cyprus is a destination that can offer a sustainable environment for business to flourish. This combined with a transparent and robust taxation system, participation in a plethora of international IP treaties and the country's continuous compliance with EU, OECD, and WIPO standards, set Cyprus at the apex of the international elite when it comes to IP.

The maximum effective tax rate of only 2.5% on income earned from IP assets offers companies an unparalleled opportunity to maximize their financial benefits. Particularly, when compared to other countries, such as the UK with an effective tax rate of 10% or Netherlands with a rate of 9%, there is no question why Cyprus remains organizations' location of preference for IP centralization.

The foregoing should not be read or construed or relied upon as legal advice in any specific or individual circumstance.

In the event of any query or need for clarification please contact the undersigned.

Keane Vgenopoulou & Associates LLC

For further information, please contact:

Thomas Keane

Partner

Tel: +357 25 25 7900

Email: tkeane@kvlaw.eu**Christina Vgenopoulou**

Partner

Tel: +357 25 25 7900

Email: cvgenopoulou@kvlaw.eu**Loukiana Protopapa**

Associate

Tel: +357 25 25 7900

Email: lprotopapa@kvlaw.eu