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CYPRUS IP BOX REGIME ENHANCED

The House of Representatives in Cyprus ratified this month amendments to the Income Tax Laws to bring the Cyprus legislation on the taxation of income from the exploitation or sale of intangible assets, in line with the provisions of the OECD BEPS Action 5 and the new EU rules.

The implementation of a new IP regime is expected to stimulate the growth driving sectors of IP exploitation and R&D.

Intellectual Property (IP) can be one of the most valuable assets of an organisation. Choosing the right location for the centralization and management of IP is a very important strategic business decision. The ideal location to establish an IP structure is one that can serve the organisation's business strategies/model, safeguard and protect its IP and contribute to its tax optimization.

Cyprus offers an efficient IP tax regime coupled with the protection afforded by EU Member States and by the signatories of all major IP treaties and protocols. Resting on a sound legal system based on common law principles and the conclusion of International Conventions on the Protection of Intellectual Property, the Cyprus new IP regime guarantees maximum protection and certainty for IP owners.

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Existing IP Box regime - Transitional arrangements

The existing IP Box regime provides for an exemption from taxation of 80 percent of the gross income from the use of the intangible following the deduction of all direct costs, such as amortization (over 5 years) and interest expense. In the case of a resulting loss, only 20 percent of the loss can be surrendered to other group companies or be carried forward to future years.

The same exemption from taxation applies for any profit arising from the disposal of the intangible.

In accordance with the transitional provisions, taxpayers benefiting from the current regime, shall be able to keep this entitlement until 30 June 2021, with respect to intangible assets, if:

a) acquired before 2 January 2016, or

b) acquired directly or indirectly from a related person during the period from 2 January 2016 until 30 June 2016 and which assets, at the time of their acquisition, were benefiting under the IP Box regime, or

c) acquired from an unrelated person or developed during the period from 2 January 2016 until 30 June 2016

For intangible assets which were acquired directly or indirectly from a related person during the period from 2 January 2016 until 30 June 2016 and which do not fall under the above provisions, a transitional period until 31 December 2016 will apply.

The income from the intangible assets which qualifies will now include embedded income as and intangible assets for which only economic ownership exists.

Only intangible assets which at 30 June 2016 have either generated income or their development has been completed will qualify for the transitional rules.

The new IP Box regime

The rules and conditions, based on the proposed amended law are applicable for assets are created after 30 June 2016, are summarized below.

- ***Qualifying intangible assets***

  "Qualifying intangible asset" means an asset which was acquired, developed or exploited by a person in furtherance of his business (excluding intellectual property associated with marketing) and which is the result of research and development activities and includes intangible assets for which only economic ownership exists.

  Qualifying intangible assets are patents, computer software and other IP assets that are non obvious, useful and novel. For the latter, it is required that the IP is utilized for the furtherance of business and does not generate annual gross revenues exceeding €7.500.000, or, €50.000.000 in case of a group of companies.

  Business names, brands, trademarks, rights to public presence, image rights and other intellectual property rights are not considered as qualifying intangible assets.

- ***Qualifying profits***

  "Qualifying profits" means the proportion of the overall income corresponding to the fraction of the qualifying expenditure plus the uplift expenditure over the total expenditure incurred for the qualifying intangible asset.

- ***Overall income***

  "Overall income" means the gross income which derives from the qualifying intangible during the tax year after deduction of direct costs (all direct and indirect costs incurred in earning the income from the qualifying intangible asset including the

amortization of the cost of the asset and notional interest on equity contributed to finance its development).

80 percent of the overall income is treated as deductible expense.

The overall income includes, but is not limited to:

- royalties or other amounts resulting from the use of qualifying intangible asset
- licence income for the operation of qualifying intangible asset
- amount received from insurance or as compensation in relation to the qualifying intangible asset
- capital gains and other income from the disposal of qualifying intangible asset
- embedded income of qualifying intangible asset generated from the sale of products or by using procedures that are directly related to this item.

  In the case of a resulting loss, only 20 percent of the loss can be surrendered to other group companies or be carried forward to future years.

- ***Qualifying expenditure***

  "Qualifying expenditure" for qualifying intangible asset is defined as the sum of total research and development costs incurred in any tax year, wholly and exclusively for the development, improvement or creation of qualifying intangible assets and which costs are directly related to the qualifying intangible assets.

  Examples of qualifying expenses include any direct costs, wages and salaries, general expenses relating to supplies and installations used for research and development, and costs associated with research and development that has been outsourced to non-related persons.

  Examples of non-qualifying expenses include cost for the acquisition of intangible assets or the acquisition/construction of immovable property, interest, costs which cannot be proved directly connected to a specific eligible intangible asset and amounts paid or payable directly or indirectly to a related person to conduct research and development activities.

  An uplift expenditure equal to the lower of a) 30 percent of the eligible costs and b) the total amount of the cost of acquisition and outsourcing to related parties for research and development in relation to the eligible intangible asset, will be added to the qualifying expenses.

- ***Accounting records***

  Proper books of account and records of income and expenses must be kept for each intangible asset for which a benefit is claimed under the new regime.

Example

Assume that a Cyprus IP company licenses its IP to its operating foreign companies and in return it receives an annual royalty income of €100.000.

Structure is shown below:

Cyprus IP Company → **Licence** → **Foreign Operating Companies**

Foreign Operating Companies → **Royalty*** → **Cyprus IP Company**

The expected annual tax for the Cyprus IP Company will be as follows:

	€
Annual royalty income	100.000
Direct expenses (assumed)	(20.000)
Net income	80.000
80% deemed deduction	(64.000)
Taxable income	16.000
Income tax on €16.000	**€1.600**
Effective tax rate	**1 .6%**

** Under the majority of Cyprus double tax treaties the withholding tax on royalty payments is 0%*

Non-qualifying assets for the IP Box regime

Expenditure of acquiring a non-qualifying intangible asset in accordance with the new rules or which do not qualify for the transitional provisions and which asset is used in furtherance of the business of the person can be amortized over the period of its useful life (maximum of 20 years) in accordance with the accepted accounting principles.

Upon sale of this intangible, a balancing statement must be prepared. This is the same treatment as when a fixed asset is sold.

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