Income tax law amendments introducing new framework relating to investement in innovative enterprises

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In brief

The Cyprus Parliament has voted into law amendments in the Income Tax Law in an aim to introduce a new framework that provides tax incentives for investing in innovative enterprises.

We set out below the main provisions of the new framework.

A. Tax deductions for individuals investing in innovative enterprise

Definition of innovative enterprise

In accordance with the amendments, a new definition for innovative enterprises is introduced, whereby a small and medium enterprise (SME) qualifies as "innovative SME" if:

(a) its operations are situated in the Republic of Cyprus

and

(b) at the time of the investment it is an unlisted SME (unless it is listed in an alternative trading platform) having a business plan for its risk finance investment and fulfils at least one of the following conditions:

(i) it has not been operating in any market or

(ii) it has been operating in any market for less than seven (7) years (this restriction does not, under certain conditions, apply for follow-on investments) following its first commercial sale or

(iii) it requires an initial risk finance investment which, based on a business plan prepared in view of entering a new product or geographical market, is higher than 50% of its average annual turnover in the preceding 5 years,

and

(c) it has been approved by the Ministry of Finance or other official authority as being a qualifying innovative SME in accordance with specified procedures and after the filing of relevant application.

It is noted that an enterprise is no longer considered a qualifying innovative SME when the total risk finance investment received reaches the maximum permissible amount set in the Commission Regulation (EU) No.651/2014 of 17 June 2014.

Methods of investing into innovative enterprises

As per the new provisions of the law, the risk finance investment into eligible innovative SMEs may take the following forms:

- direct or indirect equity investment,
- quasi-equity investment, which involves financing means whose return for the holder is predominantly based on the profits or losses of the target

enterprise and which are unsecured in the event of default (e.g. hybrid loans, debt convertible into equity etc.),
- loans and finance leases (excluding refinancing of existing loans),
- guarantees,
- mix of the above.

Tax deductions for investments by individuals in innovative enterprises

The new provisions of the law introduce tax deductions for private investors who are natural persons providing risk finance investments to innovative SMEs either directly or indirectly through multilateral trading facilities or investment funds.

More specific, the new provisions stipulate that, amongst other:

(a) the allowable deduction shall not exceed 50% of the individual's taxable income in the year the investment is undertaken,

(b) the deduction can be carried forward and claimed in the following five (5) years, subject to the aforementioned percentage cap (see (a) above),

(c) the total deductible amount cannot exceed the maximum amount of €150.000 per year,

(d) the deduction may not be granted by the Commissioner if the private investor does not hold the investment for the minimum period of three years.

In addition, anti-abuse provisions have been introduced which empower the Commissioner to refuse any deductions in the case where circumventions in the specific law provisions are detected.

The amendment is effective as from January 1, 2017 and is applicable for three (3) years, unless a new law is passed before the lapse of the three year period which extends its application either indefinitely or for a specified period.

B. Tax deductions for innovative enterprises investing into research

Tax deductions for research expenditure undertaken by innovative enterprises

The new provisions clarify the basis for deductibility of research and development expenditure, as this is recognised in accordance with international accounting standards, undertaken by innovative SMEs.

The amendment is effective as from January 1, 2017.

The takeaway

The above amendments provide tax incentives to innovative SMEs as well as to individual investors who provide risk finance investments to innovative SMEs either directly or indirectly through multilateral trading facilities or investment funds.

Talk to us to understand how the above affects your business or your personal investment plans and opportunities.

Let's talk

For an in-depth discussion of how the above amendments might affect you or your business, please contact:

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