Cyprus Income Tax Law amendments voted on Foreign Permanent Establishments and Intellectual Property

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In brief

On October 14, 2016, the following amendments to the Cyprus Income Tax Law (ITL) were voted by the Cyprus Parliament:

- Taxpayers may elect for taxation of profits earned by foreign Permanent Establishments (PEs), with a tax credit for foreign taxes incurred on the foreign PE profits. In the absence of such an election the exemption method will remain the default position.
- A new Cyprus Intellectual Property (IP) box is introduced. This retains the 80% deduction of the initial ('old') Cyprus IP box. As per a prior announcement of the Cyprus authorities the new Cyprus IP box will be fully aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 5 report and will be subject to implementing regulations which are expected to be approved by the Cyprus Parliament shortly.
- The closing of the old Cyprus IP box with transitional rules up to June 30, 2021.
- Tax amortisation is introduced for all types of IP used in business (excluding IP falling under the transitional rules of the old Cyprus IP box which continues with that box's tax amortization and goodwill).

The amendments are effective as from July 1, 2016 and will be fully enacted once published in the Government Gazette of Cyprus.

In detail

The Cyprus Parliament voted on October 14, 2016 to amend the Cyprus ITL in relation to foreign PEs and IP. Details are set out below. All provisions are to be effective as from July 1, 2016 and will be fully enacted once published in the Government Gazette of Cyprus.

Treatment of foreign PEs of Cyprus tax residents

Treatment of foreign PEs before the amendment

To date, per the Cyprus ITL, foreign PE profits are exempt from taxation in Cyprus (subject to specific anti-avoidance provisions).

Further, foreign PE tax losses may be utilized, but are subject to a recapture mechanism in case of subsequent foreign PE profits.

Election for foreign PEs introduced by the amendment

The amendment provides taxpayers with the option to elect to tax the profits of a foreign PE. In such a case tax credit for foreign taxes incurred on the foreign PE profits is available, per the provisions of the Cyprus ITL, without the need for a double tax treaty to be in place.

The exemption method will remain the default position in the absence of a taxpayer election.

Transitional rules apply for the claiming of foreign tax credits for those taxpayers that previously had utilized foreign PE tax losses whilst under the exemption method.

Cyprus IP box

As expected, based on a prior announcement by the Cyprus authorities and developments set out in the OECD/G20 BEPS Action 5 report, the amendment provides for the closing of the old Cyprus IP box, with transitional rules, and further provides for the opening of a new Cyprus IP box.

New Cyprus IP box

The new Cyprus IP box will apply as from July 1, 2016. An 80% deduction is provided for qualifying profits from qualifying IP. Accordingly, in effect, only 20% of the qualifying profits will be taxed at the rate of 12,5%.

A taxpayer may elect not to claim all or part of the available 80% deduction for a particular tax year.

Qualifying tax losses in the new Cyprus IP box are restricted to 20% of their amount.

As per a prior announcement of the Cyprus authorities the new Cyprus IP box will be fully aligned with the OECD/G20 BEPS Action 5 report and will be subject to implementing regulations which are expected to be approved by the Cyprus Parliament shortly.

The regulations will provide that qualifying IP types will include patents and copyrighted software. Marketing related IP such as trademarks will not qualify.

Qualifying profits will be determined under the OECD/G20 BEPS Action 5 nexus approach.

We will provide a further update once the details of the regulations are approved.

Old Cyprus IP box closing and transitional rules

The amendment provides that the old Cyprus IP box closed as from June 30, 2016.

Whilst IP already in the old IP box as at June 30, 2016 may continue to benefit until June 30, 2021, restrictions were introduced:

- A much shorter transitional period to December 31, 2016 applies for IPs acquired directly or indirectly from a related person during the period January 2, 2016 to June 30, 2016, unless at the time of acquisition such IPs were already benefitting from an IP box (including the Cyprus IP box) or were not acquired with the main purpose (or one of the main purposes) being tax avoidance.
- Embedded income and income earned from IPs only economically owned will only qualify in the relevant transitional period if earned from those type IPs that will qualify for the new Cyprus IP box.

A taxpayer may elect not to claim all or part of the available 80% deduction for a particular tax year.

Tax amortisation of IP

A general provision is introduced in the Cyprus ITL for tax amortisation on all types of IPs (excluding IPs falling under the transitional rules of the old Cyprus IP box which continues with that box's tax amortization and goodwill) legally or economically owned and used in business.

Tax amortisation will be calculated over the life of the IP in accordance with accepted accounting principles, with a maximum period of 20 years.

A taxpayer may elect not to claim all or part of the available tax amortisation for a particular tax year.

The takeaway

Following the amendment the treatment of foreign PEs reflects that double tax relief may be achieved through either the exemption or the credit method. The newly introduced election allows taxpayers to choose which method is most suited to their needs on a PE by PE basis. The amendment does not refer to a deadline for the foreign PE election, therefore we understand that new foreign PEs may initially be exempt (or, in the case of existing foreign PEs, continue to be exempt) and subsequently elect for taxation with foreign tax credit. We understand such election, once made, is irrevocable.

The new Cyprus IP box retains the 80% deduction. It strengthens Cyprus position as a jurisdiction for research and development as businesses may benefit from the preferential regime within the framework agreed internationally.

The transitional rules for the closing of the old Cyprus IP box are generally as expected following the release of the

OECD/G20 BEPS Action 5 report.

A general provision for tax amortisation of IP is a welcome introduction to the Cyprus ITL and will provide tax relief for expenditure incurred on IP assets.

Let's talk

For a deeper discussion of how this development might affect you or your business, please contact:

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