Tax Insights

from Tax Advisory Services

Cyprus Parliament approves new IP Box Regulations

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In brief

Following the latest intellectual property (IP) related amendments to the Cyprus Income Tax Law (ITL) (refer to our newsletter N-12-2016), the Cyprus Parliament approved, on 4 November 2016, the implementing Regulations (the Regulations). With this development, the new Cyprus IP Box, which gives an 80% deduction on qualifying IP profits, is fully aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 5 report.

The Regulations include, *inter alia*:

- The definition of qualifying IP assets;
- The definition of qualifying IP profits;
- The research and development (R&D) fraction (i.e. modified nexus fraction) applied on qualifying IP profits;
- The definition of qualifying taxpayers;
- The obligation of maintaining accounting books and records.

The IP Regulations are effective as from 1 July 2016, once published in the Official Gazette of the Republic of Cyprus.

In detail

Following the latest IP related amendments to the Cyprus ITL (refer to our newsletter N-12-2016), the Cyprus Parliament approved, on 4 November 2016, the Regulations (which are effective as from 1 July 2016, once published in the Official Gazette of the Republic of Cyprus).

Qualifying IP Assets

The Regulations set out the types of IP that constitute qualifying IP under the new Cyprus IP Box. These categories are:

- Patents,
- Copyrighted software,
- Utility models,
- IP assets that grant protection to plants and genetic material,
- orphan drug designations,
- extensions of patent protection, and
- other IP which are non-obvious, useful and novel, that are certified as such by a designated authority, and where the taxpayer satisfies size criteria (i.e. annual IP related revenue does not exceed €7,5m for the taxpayer, and group total annual revenue does not exceed €50m, using a 5 year average for both calculations)

The qualifying IP assets need to be legally and/or economically owned.

The Regulations clarify that tradenames, including brands, trademarks, image rights and other IP rights used for the marketing of goods and services do not qualify.

Qualifying IP Profits

Qualifying IP profits for the new Cyprus IP Box are determined under the OECD/G20 BEPS Action 5 (modified) nexus approach. The following types of profits, *inter alia*, are considered qualifying IP profits under the new Cyprus IP Box:

- Royalties or other amounts in relation to the use of qualifying IP,

- Amounts for the grant of a licence for the exploitation of qualifying IP,
- Amounts derived from insurance/compensation in relation to qualifying IP,
- Trading income from the sale of qualifying IP,
- IP income embedded in the sale of products, services or the use of processes directly related with qualifying IP assets.

The R&D fraction

A fraction is applied to the qualifying IP profits based on R&D activity. More specifically, the qualifying IP profits are multiplied by the R&D fraction (modified nexus fraction) to arrive at the relevant IP profits that qualify for the 80% deduction under the new Cyprus IP Box.

The R&D fraction is calculated as:

$$\frac{(QE+UE) \times QA}{OE}$$

Where:

- QE is the business' qualifying expenditure on relevant R&D incurred wholly and exclusively for the development, improvement or creation of the qualifying IP, specifically excluding, *inter alia*, acquisition expenditure and expenditure on outsourcing to related parties,
- UE is the lower of: -
  - 30% of QE, and
  - expenditure on acquisitions and outsourcing to related parties,
- OE is the sum of QE and expenditure on acquisitions and outsourcing to related parties,
- QA is qualifying IP profits.

Qualifying Taxpayers

A qualifying taxpayer, under the new Cyprus IP Box, is a taxpayer resident in Cyprus or a Cyprus permanent establishment (PE) or a foreign PE subject to tax in Cyprus.

Maintaining accounting books and records

According to the Regulations, qualifying taxpayers who wish to claim deduction under the new Cyprus IP Box are obliged to keep accounting books and records of income and expenditures per each IP.

The takeaway

With the approval of the Regulations, Cyprus offers a new tax efficient IP Box which is fully aligned with the OECD/G20 BEPS Action 5 report.

Essentially the (modified) nexus approach requires the claimant taxpayer to hold qualifying IP rights, undertake R&D activities (itself or via a taxable foreign PE or via third party outsourcing) and have qualifying IP profits.

The new Cyprus IP Box strengthens Cyprus' position as a jurisdiction for R&D and IP management as taxpayers may benefit from the preferential tax regime within the internationally agreed framework of BEPS Action 5 report.

Cyprus' geographical location, common law framework, and full EU membership coupled with the fact that Cyprus offers a highly educated workforce, well-developed IT infrastructure and R&D centres and highly-regarded universities, puts Cyprus forward as a prominent choice for the centralisation and management of R&D and IP.

Let's talk

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

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