

The Cyprus IP Box

September 2020

The House of Representatives on the 14th of October 2016 has voted amendments to the IP Box Regime in order to comply with the approach adopted by the OECD. Cyprus now also offers a tax efficient new IP Box, fully aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 5 report. Based on the new IP Box profits from qualifying intangible assets are entitled to an up to 80% deduction i.e. an effective tax rate of 2.5%, calculated as per the statutory formula set in line with the Nexus principle.

What will you get with Cyprus IP Box

The nexus fraction is used to determine the amount of qualifying profits that will give the relevant deduction to the taxpayer. The taxpayer may have a maximum 80% deduction on qualifying IP Assets depending on the results of the fraction

80% deduction of profits on disposal of IP rights:

80% of any profit resulting from the disposal of relevant intangible assets is disregarded for tax purposes. This is a generous exemption compared to other regimes as shown at the table below.

80% deduction of revenue from exploitation of IP rights

Four-fifths (80%) of the profit earned from the use of intangible assets is deducted for tax purposes. So, only 20% of IP income after deduction of the costs of earning the income, is taken into calculation. Therefore, applying to Cyprus corporate tax rate of 12.5%, which is among the lowest in the EU, provides the effective tax rate of 2.5%.

5 year amortization period

Capital expenditure related to IP acquisition or development may be deducted in the first tax year in which the expense was incurred as well as in the subsequent 4 years. That is, development or acquisition expenses are amortized over a period of 5 years. This in practice can lower the effective tax rate to less than 2%.

The Nexus Approach and Definitions

The 80% exception applies on **Qualifying Profits**. In order to calculate Qualifying Profit the Nexus formula is used:

$$\text{Qualifying Profit (QP)} = \text{Overall Income (OI)} \times \frac{\text{Qualifying Expenditure (QE)} + \text{Uplift Expenditure (UE)}}{\text{Overall Expenditure (OE)}}$$

Definitions

Qualifying intangible assets

As per the amended legislation, “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 research and development (R&D) activities, and which includes intangible assets for which only economic ownership exists.

Qualifying intangible assets comprise of:

- patents, as defined in the Patents Law
- computer software
- other IP assets which are legally protected and fall within one of the following categories:
 - utility models, intellectual property assets which provide protection to plants and genetic material, orphan drug designations and extensions of protections for patents
 - non-obvious, useful and novel, where the person utilizing them in furtherance of a business does not generate annual gross revenues in excess of €7,500,000 from all intangible assets (€50,000,000 in case of a group of companies), which are certified as such by an appropriate authority, in Cyprus or abroad.

The definition of qualifying intangible assets specifically excludes business names, brands, trademarks, image rights and other intellectual property rights used for the marketing of products and services.

Qualifying Expenditure (QE)

Qualifying expenditure for qualifying intangible assets is defined as the sum of all R&D costs incurred during any given tax year wholly and exclusively for the development, improvement or creation of qualifying intangible assets, and which costs are directly related to such assets. Qualifying expenditure includes, but is not limited to:

- wages and salaries
- direct costs
- general expenses relating to installations used for R&D
- commission expenses associated with R&D activities
- costs associated with R&D activities that have been outsourced to non-related persons

Even so, qualifying expenditure does not include:

- costs for acquisition of intangible assets
- interest paid or payable
- costs for acquisition or construction of immovable property
- amounts paid or payable directly or indirectly to a related person to conduct R&D activities, regardless of whether such
- amounts relate to cost sharing agreements
- costs which cannot be proved directly connected to a specific qualifying intangible asset

Any expenditure for R&D that has been outsourced to non-related parties, as well as any expenses of a general nature for R&D, which can not be allocated to the qualifying expenditure of a specific qualifying intangible asset, can be apportioned pro rata to the qualifying intangible assets

Uplift Expenditure (UE)

An uplift expenditure is added to the qualifying expenditure, which will be equal to the lower of:

- 30% of the qualifying expenditure
- the total cost of acquisition of the qualifying intangible assets, plus the cost of outsourcing to related parties of any R&D activities in relation to such assets

Overall Expenditure (OE)

Overall expenditure relating to qualified intangible assets is defined as the sum of:

- the qualifying expenditure
- the total cost of acquisition of the qualifying assets, plus the cost of outsourcing to related parties of any R&D activities in relation to these assets, incurred during any tax year

How can dba assist you

- Assistance in identifying qualifying IP in the business and scenario analysis and calculation
- Establishing IP companies (Cyprus Holding Company) and R&D operations
- Assistance with IP valuations

What should you expect from DBA

- *Continuous communication and discussions of the progress of setting up the Company with the Intellectual Property*
- *Continuous support at all times*
- *Good relationships with the relevant authorities by our senior team*
- *Peace of mind*

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