RSM Cyprus

The Cyprus Intellectual Property (IP) Tax Regime

Cyprus is indeed a very attractive location for the establishment of an IP holding and development company, offering an efficient tax rate as well as the legal protection afforded by EU Member States and by the signatories of all major IP treaties and protocols. On 14 October 2016, The Cyprus Parliament voted for the old IP Box regime in Cyprus to be subject to amendments and get aligned with the Provisions of Action 5 of BEPS project. The old IP regime closed from 30 June 2016, however it can be still utilised up to 30 June 2021, subject to grandfathering rules applied. The grandfathering rules can apply provided that taxpayers have intangible assets that were already used in the old regime. From 1 July 2021, the old IP regime is fully abolished, and it is replaced by the new IP regime.

Under the new Cyprus IP regime, 80% of the **qualifying profits** generated from the **qualifying assets (QA)** is deemed to be a tax deductible expense for qualifying taxpayers, resulting in an effective tax rate of as low as 2.5%. In calculating the qualifying profits, the new regime adopts the 'Nexus' approach.

According to this approach, the level of the qualifying profits is positively correlated to the extent the claimant performs R&D activities to develop the QA within the same company.

Qualifying assets under the regime include:

- patents,
- copyrighted software programs, and
- other intangible assets that are non-obvious, useful and novel.

Qualifying assets do not include trademarks, copyrights, image rights and any other IPs relating to marketing.

Qualifying persons include Cyprus tax resident taxpayers, tax resident Permanent Establishments (PEs) of non-tax resident persons as well as foreign PEs that are subject to tax in Cyprus.

Qualifying profits are calculated in accordance with the nexus fraction that follows.

The **nexus fraction** is used to determine the amount of qualifying profits that will give the relevant deduction to the taxpayer.

$$OI \times \frac{QE + UE}{OE}$$

Where: OI: Overall Income derived from the QA

QE: Qualifying Expenditure on the QA

UE: Uplift Expenditure on the QA

OE: Overall Expenditure on the QA

The **overall income (OI)** is calculated as the gross income less any direct expenditure (including the capital allowances) of this asset, i.e. the gross profit. Overall income includes, but is not limited to, royalties received for the use of the intangible asset, trading income from the disposal of qualifying asset and embedded income earned from the qualifying asset.

Capital gains arising from the disposal of a QA are not included in the overall income and are fully exempt from tax.

The **qualifying expenditure (QE)** includes salary and wages, direct costs, general expenses associated with R&D activities and R&D expenditure outsourced to unrelated parties.

The QE does not include any acquisition costs of the IP, interest paid or payable, any amounts payable to related persons carrying out R&D and costs which cannot be proved to be directly associated with a specific QA.

The **up-lift expenditure (UE)** is the lower of:

- 30% of the QE and
- The total acquisition cost of the QA and any R&D costs outsourced to related parties.

The **overall expenditure (OE)** is the sum of:

- The qualifying expenditure and
- The total acquisition costs of the QA and any R&D costs outsourced to related parties incurred in any tax year.

Cumulative nexus fraction: The nexus approach is an additive approach; the calculation

requires both that QE includes all qualifying expenditures incurred by the taxpayer over the life of the IP asset and that OE includes all overall expenditures incurred over the life of the IP asset.

Losses from the qualifying assets: Where the calculation of qualifying profits results in a loss, only 20% of this loss may be carried forward or group relieved.

Income from non-qualifying intangible assets: Income arising from non-qualifying intangible assets that are used in the business, can still benefit from certain provisions of the Cyprus tax law. In particular, capital allowances and/or notional interest deduction (NID) may be available to be deducted from such income, which should help reduce the overall effective tax rate of the company. Examples of such intangible assets include trademarks, copyrights and other IP assets.

Notional Interest Deduction (NID): NID may be available on assets introduced in a Cyprus company through equity which are employed in the production of taxable income.

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