CYPRUS IP BOX REGIME

1

In 2016 Cyprus introduced new tax rules which came to be known as the 'IP Box regime'. The rules aimed at aligning the tax treatment of IP income with the provisions of Action 5 of the OECD's Base Erosion and Profit Shifting (BEPS) project. The rules governing the IP Box regime are to be found in the Income Tax Law (the '**Law**') as well as in the **2016 Regulations** on Income Tax Law (Intellectual Property Assets)(the '**Regulations**'), passed in November 2016.

As a result of the enactment of the IP Box regime, Cyprus has become an attractive jurisdiction to both IP holding entities and IP development companies entities which wish to benefit from a very low effective tax rate. The fact that Cyprus is a member of the EU and has a robust legal framework in place which offers protection for patents, copyright, plant varieties, supplementary certificates for drugs emanating from EU directives or regulations as well as from various international treaties (such as TRIPS), renders it an even more attractive jurisdiction where businesses may opt to base their business activities.

The **Cyprus IP box regime** offers a tax benefit of **up to 80% on qualifying IP profit**, by way of *notional expense deduction*. Given that the corporate tax rate is set at 12.5%, the effective tax rate may result to **2.5%.** If a loss arises when calculating the qualifying profits, the amount that may be surrendered and carried forward is restricted to 20%.

It is important to note that the Cyprus IP box regime is based on the '**nexus approach**', which requires that for an intangible asset to qualify under the regime, a *direct link* must be established between the IP rights which generate the *qualifying income* and the *own qualifying expenditure* which has contributed to that income.

'Qualifying intangible assets' are defined as:

- assets which have been acquired, developed or exploited by a person in the course of business, and

- which constitute intellectual property, however, excluding any intellectual property which is connected with marketing[1] and

- which are the result of research and development, and includes any intangible asset for which there is only economic ownership.

The Regulations list the following as QIAs (exhaustive list):

(i) patents (as these are defined in the law on Patents)

(ii) software programs and

(iii) any other intellectual property assets which are protected by law and which fall within the following sub-sections-

(a) utility models, intellectual property assets providing protection to plants and genetic material, orphan drug designations and extensions of patents;

(b) ones which are not obvious, are useful and inventive, where the person who is exploiting them in the course of business does not earn a gross income over 7,500,000.00 EUR per year deriving from all the intellectual property assets and in case of a group of such persons, the group does

[1] As a result, trade marks, image rights, etc. would not fall within the definition of QIA. It is important to note that income arising from non-qualifying intangible assets used in the business may nonetheless benefit from other tax deductions. As a result, expenses relating to trade marks, as well as other forms of copyright which do not come within the definition of QIAs, as well as other IP assets, may give rise to tax benefits and should thus be assessed separately.

not earn over 50,000,000.00 EUR turnover on a global level, using an average of 5 (five) years for both of the abovementioned calculations. Such IP assets **do not include** trade names, including brands, trade marks, image rights and/ or public presence/ image rights, nor other IP rights which are used for the **marketing of goods and services**.

There is a requirement that the QIAs be certified as such by a respective competent authority in the Republic or abroad.

As a result of the application of the **modified nexus approach**, one must determine the amount of qualifying profits which in turn, would determine the relevant tax deduction due.

'Qualifying profits' means the sum which results from the application of the following formula:

QE+UE x QA OE

Where:

- **QE:** means qualifying expenses for a QIA over its life
- **UE:** means additional expenditure
- **OE:** means total expenditure for a QIA over its life
- **QA:** means total income resulting from the QIA ('overall income'; see more detailed definition below).

QUALIFYING EXPENDITURE

QE for a QIA consist of the sum of the total expenditure for research and development carried out during any tax year entirely and exclusively for the development, improvement or creation of the QIA and this expenditure relates directly to the QIA.

QE may include, but are not limited to, the following:

(i) Salaries and wages;

(ii) Direct expenditure;

(iii) General expenses related to premises used for research and development;

(iv) Expenditure for commissions related to research and development activities;

(v) Expenditure related with research and development which has been assigned to non-related persons, but which does not include- (1) acquisition cost for the acquisition of an IP asset; (2) interest paid or which is payable; (3) cost relating to the acquisition or erection of immovable property; (4) sums paid or which are payable directly or indirectly to a related person for the carrying out of research and development activities, irrespective if these sums concern an agreement for the apportionment of cost; (5) cost which may not be proven that it relates directly to a specific QIA.

The Regulations clarify that any expenditure for commissions to non-related persons related to relevant R&D activities, as well as any expenditure of general and theoretical nature for R&D which cannot be apportioned in the qualifying expenditure of a specific QIA with which there is a direct relationship, may be apportioned proportionately amongst the QIAs.

3

'Lift-up expenditure' means the lowest of:

(i) 30% of qualifying expenditure and

(ii) The total sum for the recovery cost and of the outsourcing cost to related persons to carry out research and development in relation to the QIA.

'Overall expenditure' for a QIA means the sum of:

(i) QE and,

(ii) The total acquisition cost and any outsourcing costs to related persons concerning research and development activities in relation to a QIA which have been carried out during any tax year.

'Overall income' which results from a QIA means the gross income resulting within a financial year, less any *direct expenditure* for the generation of the said income.

Overall income may include, but is not limited to, the following:

(i) Exploitation rights or other sums in relation to the use of the QIA;

(ii) Any sum for the grant of a license for the exploitation of the QIA;

(iii) Any sum which results from insurance or indemnity in relation to a QIA;

(iv) Income from the sale of a QIA, excluding any capital gains profits;

(v) Embedded income of a QIA which results from the sale of goods, services or from the use of procedures which relate directly to the said asset.

- For the purposes of the foregoing, '**direct expenditure**' includes all expenses made directly or indirectly, entirely and exclusively for the earning of income from the QIA.
- Any tax discount granted pursuant to article 33(5) of the Income Tax Law resulting from the exploitation or sale of IP assets, shall be considered as a *direct expense* for the purposes of calculating profits or losses.
- The tax discount granted pursuant to the provisions of article 9B of the Law which corresponds to IP assets, is considered as a *direct expense* for the purposes of calculating profit.
- For the purposes of the Regulations, any capital expense for the acquisition of a QIA which is calculated in accordance with the first reservation of para. (l) of 9(1) of the Law, is considered as 'direct expense'.

Any person who wishes to claim a tax deduction in accordance with these Regulations, has the obligation to keep accounting books and records of their incomes and expenditures *per IP asset*.

The taxpayer has the right for every tax year not to claim all or part of the deduction offered by the Regime.

The Regulations apply in relation to '**Qualifying tax residents**'. A qualifying tax resident is a Cyprus tax resident, tax-resident permanent establishments of non-tax-resident persons and foreign permanent establishments that have chosen to be subject to tax in Cyprus.

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