

Amendments to the Cyprus Intellectual Property regime

In an effort to fully align the existing IP regime with the parameters of the relevant OECD recommendations of the BEPS Action 5, on 14th October 2016 amendments to the current Cyprus Intellectual Property (IP) regime have been adopted and will apply retrospectively as from 1st July 2016.

The amendments do not provide for a change to the current effective tax rate of 2.5% as provided under the current IP regime, but rather focus on the application of the modified nexus approach and the narrowing down of the definition of what is a “qualifying” IP asset. In addition, the amendments also include transitional arrangements, allowing the provisions of the current IP regime to continue to apply up and until the 30th of June 2021.

Grandfathering provisions

The provisions of the existing IP regime will continue to apply in relation to the following IP assets:

- i. Existing IP assets (i.e. IP assets qualifying under the current provisions of the Cyprus IP regime as at 2nd January 2016);
- ii. IP assets acquired (directly or indirectly) from related parties, during the period from 2nd January to 30th June 2016, provided that such IP assets would have been eligible to qualify under the provisions of the current Cyprus IP regime or a similar IP regime; and
- iii. IP assets acquired from a non-related party or developed during the period from 2nd January to 30th June 2016.

The current provisions of the Cyprus IP regime will expire on the 31st December 2016 for IP assets acquired either directly or indirectly from related parties, during the period from 2nd January to 30th June 2016 if such assets have not been eligible to claim the current provisions of the Cyprus IP regime or a similar IP regime as per (ii) above.

Qualifying IP assets

The changes restrict qualifying IP assets to patents, computer software, as well as IP assets which are non-obvious, useful and novel and from which the income of a taxpayer does not exceed, in a 5-year period, €7.500.000 per annum (€50.000.000 for taxpayers forming part of a Group).

Further, qualifying IP assets under the modified nexus approach do not cover trademarks including brands, image rights and other intellectual property rights used for the marketing of products or services.

The modified nexus approach

According to the “modified nexus approach”, there should be sufficient substance and an essential nexus between the expenses, the IP assets and the related IP income in order to benefit from a patent box regime. Under the nexus approach, the application of an IP regime should be dependent on the level of Research and Development (R&D) activities carried out by the qualified taxpayer.

The following formula has been introduced to determine the qualifying profits that can benefit from an IP regime under BEPS:

$$[(\text{Qualifying expenditure} + \text{Up-lift expenditure}) / \text{Total expenditure}] \times \text{Overall IP Income}$$

Qualifying expenditure, excludes the R&D costs of outsourcing to related parties, contrary to the cost of outsourcing to unrelated parties which are considered as part of ‘qualifying expenditure’. In addition, the amendments provide for a maximum 30% up-lift of “qualifying expenditure”, thus allowing qualified taxpayers to include all or part of non-qualifying R&D costs to be included as part of the “qualifying expenditure”.

Foreign Permanent Establishments (PEs)

Under the modified nexus regime, foreign PEs of Cyprus tax resident companies engaged in R&D activities give rise to “qualified expenditure” provided that they make an election so that their profits are taxed in Cyprus. It should be noted that such an election is irrevocable. In the instance where the profits of the foreign PEs are taxed abroad, a unilateral tax credit relief will be afforded in Cyprus, up to the amount of the tax payable in Cyprus on such profits.

Tracking of income and expenditures

Taxpayers are required to maintain books and records in relation to income and expenditure per qualifying asset so as to track expenditure and income to ensure that the income receiving benefits did, in fact, arise from the qualifying expenditure incurred.

Note: The Regulations regarding the application of the modified nexus regime have not yet been voted by the House of Representatives to date.

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