

# TAX update

11/16

THE NEW CYPRUS IP BOX REGIME

  
KINANIS

## A. INTRODUCTION

The House of Representatives has voted amendments to the IP Box Regime in order to comply with the guidelines and requirements of the OECD. The new amendments bring the legislation in Cyprus on the taxation of Royalties (IP Box) in full compliance with OECD. This will ensure stability in the methodology of calculating taxes on royalties and will therefore enable investors to plan accurately for the future.

It is also important to state that the new law, under some conditions, gives the opportunity for those that were benefiting from the old IP box regime to continue to benefit as until the end of June 2021.

The amendments to the IP Box Regime are effective as from 30<sup>th</sup> of June 2016.

## B. THE OLD REGIME

The old regime was introduced in 2012 and in order for an Intellectual Property (IP) holder to benefit from the law the following conditions were to be met.

- The IP right should be a Qualifying IP
- The Cyprus company should be owner of the Qualifying IP
- The Qualifying IP should be used for the production of taxable income

According to the legislation, intangible assets that were defined by the Patents Law, Trade Marks Law and the Intellectual Rights Law were considered as a Qualifying IP Right for the purposes of the IP Box Regime.

In order for a Cyprus IP Holding Company to qualify under the IP tax provisions it must be the **owner** of the Qualifying IP Right.

Further the Cyprus IP Holding Company should use the Qualifying IP Right for the production of taxable income. This means that the IP Right should be licensed to other parties in exchange for royalty income.

Provided that the above conditions were met, 80% of "Royalty Profit" generated from Qualifying IP Rights was considered as deemed expenses for corporation tax purposes. The remaining 20% was subject to the normal corporation tax rate of 12.5%, making thus the maximum effective tax rate to be 2.5%.

## C. GRANDFATHERING RULES

The amendments to the law provide that persons will continue to benefit from the Old Regime until 30<sup>th</sup> of June 2021 provided that the Qualifying IP:

- a. Was acquired before 2 January 2016.
- b. Was acquired directly or indirectly from a related person during the period from 2<sup>nd</sup> of January 2016 until 30<sup>th</sup> of June 2016 and which assets.
  - At the time of acquisition were benefiting under the IP box regime or under similar scheme of another member state, or,
  - Where not acquired with main or one of the purpose the avoiding of taxes
- c. Was acquired from unrelated person or developed during the period from 2<sup>nd</sup> January 2016 until 30<sup>th</sup> of June 2016.

A Qualifying IP that was acquired directly or indirectly from a related person during the period from 2<sup>nd</sup> of January 2016 until 30<sup>th</sup> of June 2016 and does not meet the above grandfathering rules, will continue to benefit from the Old Regime until 31<sup>st</sup> of December 2016.

## D. THE PROVISIONS OF THE NEW IP BOX REGIME

The new provisions of the law will apply for Qualifying IP's which are developed after 1<sup>st</sup> of July 2016. The new IP Box Regime provides that 80% of Qualifying Profits generated from these Qualifying IP's will be considered as deemed expenses and only 20% will be subject to 12.5% corporation tax. Thus the maximum effective tax rate will be 2.5%.

### 1. Qualifying IP

A qualifying IP means an asset which was acquired, developed or exploited by a person in the course of his business and it is a result of research and development. It also includes assets for which only economic ownership exist.

These assets are:

- Patents as defined in the Patents Law
- Computer Software
- Other IP assets which are legally protected and they fall under one of the following:
  - a) Utility Models.
  - b) Nonobvious, useful and novel where the person utilising does not generate gross revenues over EURO 7,500,000 or in the case of a group not more than EURO 50,000,000 using a weighted average method of the last 5 years for the calculation of both figures. The IP assets mentioned in this point should be certified by an Appropriate Authority in Cyprus or abroad.

**Important Note:** Business names (including brands), trademarks, image rights and other intellectual property rights used to market products and services which used to benefit from the Old IP Regime will not be considered as Qualifying Intangible Assets in the New Regime.

## 2. Qualifying Profit

The term Qualifying Profit is calculated as follows:

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

Where: QE: Qualifying Expenditure  
 UE: Uplift expenditure  
 OE: Overall expenditure  
 QA: Overall Income

### a) Qualifying Expenditure (of capital nature)

Qualifying Expenditure is defined as the total expenses for research and development carried out wholly and exclusively for the development, improvement or creation of a Qualifying IP in any fiscal year. The above expenditure should be a direct expenditure.

Qualifying Expenditure includes but is not limited to the following:

- Wages and Salaries for research and development
- Direct Costs
- General expenses relating to the facilities used for research and development
- Expenses for supplies relating to research and development
- Expenditure relating to research and development which has been outsourced to an unrelated party

But they do not include:

- Cost of acquisition of intangible assets
- Interest paid or payable
- Costs for the acquisition or development of immovable property
- Amounts paid or payable directly or indirectly to a related party to conduct research and development irrespective of whether these amounts relate to a cost sharing agreement
- Cost which cannot be proved that related directly to the Qualifying Asset

### **b) Uplift Expenditure**

Uplift Expenditure means the lower of:

- 30% of qualifying expenditure, or
- The total amount for the cost of acquisition and the research and development outsourced to related parties

### **c) Overall Expenditure**

Overall expenditure means the total capital expenditure either qualifying or not, relating to the creation of the Qualifying IP.

### **d) Overall Income**

The term Overall Income refers to the gross income arising from the Qualifying IP in a tax year less the direct costs incurred for the production of this gross income. The term includes but it is not restricted to the following:

- Royalties or other amounts in relation to the use of the Qualifying IP
- Any amount received as license for the use of a Qualifying IP
- Any amount received from insurance or compensation in relation to the Qualifying IP
- Embedded income of the Qualifying IP which income derives from the sale of goods, services or procedures relating directly with the Qualifying asset

Direct costs include:

- All direct or indirect costs incurred in earning the income from the qualifying intangible asset
- The amortization of the cost of the intangible
- Notional Interest Deduction (NID) on equity contributed to finance the development of the qualifying intangible asset

## **3. Accounting Records**

Any person who claims benefit under the new Regime should maintain proper books and records in accordance with the laws in Cyprus.

## E. EXAMPLE

A Cyprus Company engaged in the production of mobile applications has developed a mobile game application. The development of the game took place in July 2016 and is expected to finish in December 2016. The game that will be launched to the market early 2017.

This is the only application that the company developed during this period.

The costs incurred by the company for this specific game application were as follows:

1	Wages of the persons developing the game	70
2	Rent and Rates	15
3	Research and Development outsourced to a company which belongs to the same beneficial owner	25
4	Research and Development expenses outsource to a subsidiary company	40
5	Gross Income	250
6	Research and Development outsourced to an unrelated company	15
7	Direct Costs- Promotion Expenses	50

### a. Overall Expenditure

Overall Expenditure of capital nature includes the following:

Wages of the persons developing the game	70
Rent and Rates	15
Research and Development outsourced to a company which belongs to the same beneficial owner	25
Research and Development expenses outsource to a subsidiary company	40
Research and Development outsourced to an unrelated company	15
<b>Total</b>	<b>165</b>

### b. Qualifying Expenditure

Wages of the persons developing the game	70
Rent and Rates	15
Research and Development outsourced to an unrelated company	15
<b>Total</b>	<b>100</b>

Research and Development outsourced to an unrelated company and to a company which belongs to the same beneficial owner are not considered as Qualifying Expenditure.

### c. Maximum up Lift Expenditure

Maximum up-lift amount is the lower of:

- 30% of Qualified expenses (100 x 30%) = 30

**OR**

- The total amount for the cost of acquisition and the research and development outsourced to related parties (25 + 40) = 65

Therefore the uplift allowed is 30.

### d. Overall Income

Gross Income	250
Direct Costs- Promotion Expenses	(50)
<b>Total</b>	<b>200</b>

### e. Qualifying Profit

$$\frac{QE+UE}{OE} \times \frac{QA}{165} = \frac{100+30}{165} \times 200 = 157.57$$

Therefore out of the 200 of overall income, the amount of 157.57 will be taxed under the IP Box Regime and the amount of 42.43 will be taxed under normal tax.

### f. Tax Computation

	IP Box	Normal Rates	Total
Qualifying Income/Income	157.57	42.43	200.00
80% deemed expense (80% x 157.57)	(126.06)		(126.06)
Taxable profit	31.51	42.43	73.94
<b>Tax liabilities at 12.5%</b>	<b>3.94</b>	<b>5.30</b>	<b>9.24</b>

In case of taxable losses under the IP Box Regime only 20% can be surrendered to other group companies or carried forward for the next year.

## F. FUTURE OF TRADEMARKS

Trademarks are not included in the list of Qualifying IP under the new scheme therefore it will not be possible to enjoy the benefits of the new Cyprus IP Box.

However, with careful tax planning it may still be possible to hold trademarks or any other non-qualifying IP under a Cyprus company and receive royalties while ensuring low overall effective taxation on the royalty income as well as the applicability of provisions of various Double Tax Treaties.

Companies receiving royalty income generated from non-qualifying IP asset should seek professional advice in order to revisit their current structures and adapt to the provisions of the new legislation.

## G. CONCLUSION

We have seen the Cyprus Government continuously improve local legislation in an effort to maintain and improve Cyprus' position and reputation as an international business centre. Given that all other European countries having similar regimes must also comply with OECD requirements we believe that Cyprus has retained its competitive advantage and will play a significant role in the growing global Intellectual Property market.

In light of the new requirements, as set by OECD, it is possible that some business may choose to relocate to a jurisdiction that offers an attractive IP Regime. Cyprus with its current and developing infrastructure, supply of highly qualified personnel, lower operating costs and possibilities of obtaining EU funding, provides the optimum economic environment to a wide range of companies, whether small, medium or large, to establish themselves in Cyprus and continue to benefit from the Cyprus IP tax regime.

## H. HOW KINANIS LLC CAN ASSIST

- Registration of IP whether national, community or international.
- Providing International Tax Optimization Advice.
- Consultation if an IP asset is protected under the law.
- Advising and drafting IP transactions, including financing, acquisitions, sales and licenses.
- Restructuring advice to groups in order to retain relief under the new regime.
- Assistance in setting up offices in Cyprus
- Assistance in setting up an appropriate board of directors for the IP Company.



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## Our Firm

**Kinanis LLC**, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 33 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered “All in one place”, so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

This combination of legal, accounting and tax services through our well qualified personnel and our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field. Our involvement in international financial transactions has also provided us with the extensive expertise in representing groups, corporations, funds as well as the private client.

The firm is staffed with around 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

We always look to give solutions in a simple and as possible quick way focusing on the needs of each client trying to anticipate the issues before becoming a problem.

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