PICCO Tax Newsletter
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Intellectual Property (IP) regime in Cyprus

The real competitive advantage

Intellectual Property (IP) can be one of the most valuable assets of an organization. Therefore, choosing the appropriate regime/location for structuring the exploitation of IP assets is vital for an organization in order to achieve efficient business development, effective IP protection and maximization of tax saving.

On 14 October 2016, The House of Representatives approved amendments to the Income Tax Law which results the Cypriot legislation on the taxation of the income from the exploitation or sale of intangible assets (IP), be in line with the recommendations of the Organization for Economic Co-operation and Development (OECD) Action 5 of the Base Erosion and Profit Shifting (BEPS). This is based on a “modified nexus approach”. A taxpayer can benefit from the provisions of a particular IP tax regime if IP income is generated through incurred Research and Development (R&D) expenditures. The Cypriot IP regime could be called as the most beneficial IP regime in Europe.

The Nexus approach links the benefits of the regime with the R&D expenses incurred by the taxpayer. Particularly, the taxpayers will be eligible to claim a tax deduction equaling to 80% of qualifying profits resulting from the exploitation of the qualifying IP assets. In the case of a resulting loss, only 20% of the loss can be surrendered to other group companies or be carried forward to subsequent years. A company which is eligible for the IP regime, it could achieve an effective tax rate up to 2,5%.

<table>
<tr><th colspan="4">INTELLECTUAL PROPERTY (IP) REGIME</th></tr>
<tr><td rowspan="24">IP Asset</td><td rowspan="4">Qualifying IP Assets</td><td>Software</td><td>√</td></tr>
<tr><td>Patents</td><td>√</td></tr>
<tr><td>Other (upon confirmation)</td><td>√</td></tr>
<tr><td>Trademarks</td><td>x</td></tr>
<tr><td rowspan="4">Qualifying Income (QI)</td><td>Exploitation Income (i.e. Royalties, Licenses etc)</td><td>√</td></tr>
<tr><td>Embedded Income</td><td>√</td></tr>
<tr><td>Disposal of IP Asset</td><td>√</td></tr>
<tr><td>Marketing</td><td>x</td></tr>
<tr><td rowspan="9">Qualifying Expenditure (QE)</td><td>Directly related expenses</td><td>√</td></tr>
<tr><td>Notional Interest Deduction (NID) - NID Regime</td><td>√</td></tr>
<tr><td>General expenses related to R&D activities</td><td>√</td></tr>
<tr><td>Expenses for supplies related to R&D activities</td><td>√</td></tr>
<tr><td>Third Party outsourced services</td><td>√</td></tr>
<tr><td>Acquisition of IP</td><td>x</td></tr>
<tr><td>Interest</td><td>x</td></tr>
<tr><td>Related Party (RP) outsourced services</td><td>x</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td>Uplift Expenditure (UE)</td><td colspan="2">Lower of:
- 30% of QE
- Acquisition cost + RP R&D cost outsourced</td></tr>
<tr><td>Overall Expenditure (OE)</td><td colspan="2">QE + Acquisition cost + RP R&D cost outsourced</td></tr>
<tr><td>Overall Income (OI)</td><td colspan="2">QI - Direct Expenses related to IP asset</td></tr>
<tr><td>Qualifying Profits (QP)</td><td colspan="2">[(QE + UE) / OE] x OI</td></tr>
<tr><td>Tax Deduction (Notional Expense)</td><td colspan="2">QP x 80%</td></tr>
<tr><td colspan="2">Effective Tax rate</td><td>up to 2,5%</td></tr>
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Numerical Example:

We assume a newly established CY Company, during the tax year 2020, has issued share capital of EUR 50.000 at a premium of EUR 50.000. Therefore, there is a total new equity of EUR 100.000. This amount has been invested in two assets:

1. Software → EUR 80.000
2. Shares → EUR 20.000

At the year-end 2021, the Company generated the following income:

1. Royalty → EUR 50.000
2. Dividends → EUR 5.000

In order the Royalty income to be generated, the Company incurred the following expenditures:

R&D expense:	**Accumulated**	**2020**	**2021**
Outsource non-RP	43.000	40.000	3.000
Outsource RP	26.000	25.000	1.000
Inhouse	17.000	15.000	2.000

CY tax resident company	A
Share Capital	**50.000,00**
Share Premium	**50.000,00**
Total New Equity	**100.000,00**
Invested to:	
Software (IP Asset)	**80.000,00**
Shares	**20.000,00**
Tax Computation	2021
Royalty	50.000
Dividends	5.000
R&D exp.	- 6.000
Total Profits	49.000
Less exempted income	5.000
Taxable Profit	**44.000**
Tax payable	**5.500**
Effective tax rate	**12,50%**

IP calculation:

R&D expense:			
Outsource non-RP	43.000		
Outsource RP	26.000		
Inhouse	17.000		
QE: 60.000,00			
UE: 18.000,00			
OE: 86.000,00			
Net Royalty	(50.000-6.000)=	**44.000**	
Qualified IP Income		**39.907**	91%
IP Deduction	**31.926**	=41.600*80%	
Taxable Profit	**12.074**	=44.000-37.818	
Tax payable	**1.509**		
Effective tax rate	**3,43%**		
Tax Saving	**9,07%**		

It is important to note that the tax legislation gives the opportunity to use the Notional Interest Deduction (NID) tool simultaneously with the IP regime since the NID is treated as Qualified Expenditure. In this respect, the effective tax rate could be reduced below 2.5%.

Using the previous numerical example, we provide how the calculations may be changed and the effective tax rate is reduced further.

CY tax resident company	A
Share Capital	**50.000,00**
Share Premium	**50.000,00**
Total New Equity	**100.000,00**
Invested to:	
Software (IP Asset)	**80.000,00**
Shares	**20.000,00**
Tax Computation	2021
Royalty	50.000
Dividends	5.000
R&D exp.	- 6.000
Total Profits	49.000
Less exempted income	5.000
Taxable Profit	**4.000**
Tax payable	**5.500**
Effective tax rate	**12,50%**

IP calculation:

R&D expense:		
Outsource non-RP	43.000	
Outsource RP	26.000	
Inhouse	17.000	
NID (80k*5,536%)	4.429	
QE:	64.429,00	
UE:	19.328,70	
OE:	90.429,00	
Net Royalty	**44.000**	
Qualified IP Income	**40.754**	92,62%
IP Deduction	**32.603**	=40.754*80%
Taxable Profit	**6.968**	=44.000-32.603-4.429
Tax payable	**871**	
Effective tax rate	**1,98%**	
Tax Saving	**10,52%**	

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