

CYPRUS INTELECTUAL PROPERTY BOX

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OVERVIEW

Cyprus offers one of Europe's most attractive Intellectual Property (IP) Box Regimes and offers the lowest effective tax rate at 2.5%. The Cyprus IP Box regime is fully aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 5 report. IT and Pharmaceutical companies who set up an IP Box in Cyprus, can also enjoy priority in residency permits for their directors and key employees. Qualifying tax payers that are eligible for the IP regime include Cyprus tax residents, permanent establishment (PEs) of non-resident persons and foreign PEs that are subject to tax in Cyprus.

AT A GLANCE

The key features of the IP Box Regime are:

- IP Licensing: Profits derived from licensing the IP may be subject to tax as low as 2.5%
- Sale of the actual IP (capital nature) is tax exempt.
- Sale of products that have an embedded IP also falls under the IP box regime.
- Where a loss is incurred, when calculating Qualifying Profits (QP) only 20% of this loss can be carried forward as per the new regime or group relief.
- If shares of the IP Box are sold, 100% of profits are exempt from tax
- Royalty payments from non EU entities are normally subject to zero or low withholding tax in accordance with the double tax treaty if any is in place
- Royalty payments from EU entities are not subject to withholding tax as per the EU Royalty Directive. No withholding tax if a Cyprus IP Box company makes royalty payments to a non-tax resident entity if the IP is not used in Cyprus
- Dividends paid out by a Cyprus company to a non-resident shareholder are not subject to withholding tax
- Dividends received by a Cyprus Company are exempt from income tax and subject to withholding tax as per the double tax treaty in place.

EXPLOITATION OF IP RIGHTS

There are two key ways in which IP can be exploited:

- IP Licensing: Owner of IP receives royalties from licensing of IP. Profits derived from this licensing may be subject to tax as low as 2.5%. Please note the practical examples on page 4 below.
- Sale of IP: Owner of IP sells shares in Cyprus IP box. There is no tax on the profits earned.
- Sale of the actual IP (capital nature) is tax exempt.
- Sale of products that have an embedded IP also fall under the IP Box regime.

THE IP BOX REGIME

On the 14th October 2016, the House of Representatives passed changes to the Income Tax Law to align Action 5 of the OECD's Base Erosion and Profit Shifting (BEPS) project with the Cyprus IP law.

The provisions of the Income Tax Law for the treatment of intangible assets have been amended on the 14th August 2020 and apply retrospectively from the 1st January 2020. These tax changes do not apply for intangible assets that were registered prior to the 30th June 2016 and which fall under the grandfathering provisions of the law.

The key changes to the Income Tax Law affecting IP are:

- Abolishment of any tax on gains realized from the disposal of the intangible assets, as well as on the capital allowances that are claimed as a tax deduction; and
- The ability to claim capital allowances over the entire useful life of the intangible asset.

THE NEXUS FRACTION

The nexus approach provides that there should be enough substance and an essential nexus between expenses, IP assets and the related IP income in order to benefit from the IP Box regime.

$$QP = \{ [QE + UE] / OE \} * OI$$

QUALIFYING ASSETS (QA)

Qualifying Assets (QA) which can benefit from the IP Box regime are intangible assets excluding brands, image rights, trademarks and copyrights, they include:

- Patents
- Software Programs (copyrighted)
- Other useful, innovative IP from which the income of the taxpayer does not exceed EUR 7.5 Million per annum or EUR 50 Million as a group, over a 5 year period.

QUALIFYING EXPENDITURE (QE)

Qualifying Expenditure (QE) is the direct costs including salary, wages, commission expenditure and general expenses related to the R&D activities paid to unrelated parties.

It excludes the cost of acquiring the QA, any interest, salary, wages and general expenses paid to individuals undertaking the R&D which cannot be directly linked to the QA.

UPLIFT EXPENDITURE (UE)

Uplift Expenditure (UE) is calculated as the lesser amount of either:

- 30% of the Qualifying Expenditure (QE) or;
- The total cost of acquiring the QA plus R&D costs outsourced to related parties.

OVERALL EXPENDITURE (OE)

Overall Expenditure (OE) is the qualifying expenditure plus the total costs incurred to develop or acquire the QA, including R&D costs paid to related third parties in any tax year.

THE QUALIFYING PROFITS (QP)

Qualifying Profits (QP) are calculated using the nexus approach whereby IP can qualify for the benefits of this IP Box regime if there is a direct link between the qualifying income and expenses that result in that profit.

To calculate the Qualifying Profits (QP) the sum of the Qualifying Expenses (QE) and Uplift Expenditure (UE) are divided by the Overall Expenditure (OE) and then multiplied by the Overall Income (OI) derived from Qualifying Assets.

OVERALL INCOME (OI)

Overall Income (OI) is the gross income minus any direct expenditure and includes:

- Royalties or other amounts from the use or grant of license to exploit the QA.
- Amounts sourced from Insurance/Compensation relating to QA
- Trading income from sale of the QA
- Embedded income from the QA

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CAPITAL ALLOWANCES

It is important to note that as of 2016, capital costs of IP (excluding goodwill and qualifying assets as per the above definition) although not eligible for the IP Box regime under the nexus approach, they are tax deductible as capital allowances

NOTIONAL INTEREST DEDUCTION (NID)

Similarly, Notional Interest Deduction (NID) may be available on assets if these were introduced in a Cypriot company as equity and generate taxable income.

PRACTICAL EXAMPLES

We set out below three distinct scenarios, A to C, where assets are either developed internally or externally by related or non-related (third) parties.

The nexus fraction is applied to calculate the Qualifying Profits and tax benefits incurred in each case. Depending on the scenario in each example we will need to ascertain whether the IP was developed inhouse or acquired. We will also ascertain whether R&D costs were incurred in-house, outsourced to related parties or to third parties.

- Scenario 1 : The Qualifying Asset is acquired and R&D expenses to non-related third parties who further develop the asset, are incurred
- Scenario 2 : The Qualifying Asset is acquired and R&D expenses to related third parties who further develop the asset are incurred
- Scenario 3 : The Qualifying Asset is developed in-house and all further R&D expenses are incurred inhouse by the Cyprus IP Box itself.

Overall Income (OI)	€10 000 000	€10 000 000	€10 000 000
Cost of acquiring asset	€3 000 000	€3 000 000	n/a
Internal R&D expenses	n/a	n/a	€5 000 000
Outsourced R&D expenses to non-related parties	€2 000 000	n/a	n/a
Outsourced R&D expenses to related parties	n/a	€2 000 000	n/a
Overall Expenditure (OE)	€5 000 000	€5 000 000	€5 000 000
Internal R&D expenses	n/a	n/a	€5 000 000
Outsourced R&D expenses to non-related parties	€2 000 000	n/a	n/a
Qualifying Expenditure (QE)	€2 000 000	n/a	€5 000 000
30% of Qualifying Expenditure	€600 000	0	€1 500 000
Total Cost of Acquisition + Cost of Outsourcing to related Parties	€3 000 000	€5 000 000	0
Uplift Expenditure (UE)	€600 000	0	0

In the subsequent table the Qualifying Profit is then further calculated, clearly indicating the Notional Deduction:

- Scenario 1 : The Notional Deduction on the Qualifying Profits is €4,160,000 therefore the effective tax rate is 7.3%
- Scenario 2 : There is no Notional Deduction in this scenario
- Scenario 3 : The Notional Deduction on the Qualifying Profits is €8,000,000 therefore the effective tax rate is 2.5%

		Qualifying Profit (QP)	Notional Deduction (80% of QP)
Scenario A	$€10\,000\,000 * \{ (€2\,000\,000 + €600\,000) / €5\,000\,000 \}$	€5 200 000	€4 160 000
Scenario B	$€10\,000\,000 * \{ (€0 + €0) / €5\,000\,000 \}$	€0	€0
Scenario C	$€10\,000\,000 * \{ (€5\,000\,000 + €0) / €5\,000\,000 \}$	€10 000 000	€8 000 000

IP BOX COMPARISON

Cyprus offers one of Europe's most attractive regimes as highlighted in the table below – as the effective tax rate can be as low as 2.5%. In comparison to the UK, Netherlands and Luxembourg amongst others, Cyprus offers a wider application on which qualifying assets and expenses can qualify under the IP Box regime.

	Cyprus	Netherlands	Luxembourg	United Kingdom	Belgium	Hungary	France
Effective Tax Rate	2,5%	7%	5,2%	10%	4,44%	4,5%	10%
Qualifying IP Assets	Patents, computer software, utility models, other IP assets such as nonobvious, useful or novel rights	Self-developed intellectual property relating to patents, copyrighted software, or approved R&D	Patents, trademarks, designs, domain names, models and software copyrights, brands for services for goods such as productions and marketing know-how	Patent and rights similar to it	Patents and supplementary patent certificates, copyrighted software	Patents, utility model protection, copyrighted software	Patents, utility certificates, copyrighted software
Ineligible IP Assets	Business names, trademarks, image rights, marketing activities	Trademarks, brands and acquired IP	Formulas, copyrights (other than software)	Trademarks, copyrights, and designs	Know-how, trademarks, designs, models, formulas, and processes	Designs	Non patentable inventions, R&D activities
Internally Developed or Acquired?	Internally developed and acquired intellectual property	Self-developed only	Internally developed and acquired intellectual property, but not IP acquired from a related party	Internally developed and acquired intellectual property	Self-developed IP rights or acquired or licensed from third parties	Internally developed and acquired intellectual property	Internally developed and acquired intellectual property
Limitations on Where R&D Takes Place	Some	Some	None	None	Some	None	None
Qualifying Revenue	Royalty, licensing fees, compensation income, trading profits from the disposal of IP, capital nature gains form the disposal not subject to any tax	Net income from qualifying assets	Royalties net of costs (amortisation, R&D costs, interest)	Net income from qualifying intellectual property	Patent income	Royalties	Net results derived from licensing, sublicensing or selling of qualifying of IP rights
Deduction Rate	80%	None – reduced tax rate	80%	None – reduced tax rate	85%	50%	None-reduced tax rate
Overall Limit of Deduction	None	None	None	None	100% of pre-tax income	50% of pre-tax income	None
Gains on Disposal Included	Yes	Yes	Yes	Yes	No	Yes	Yes

MEMBERSHIP IN IP TREATIES

Cyprus is a treaty member to all the key international treaties and IP protocols, offering the highest level of protection and assurances for IP owners. Some of the key treaties Cyprus is a signatory to include:

- WIPO – World Intellectual Property Organisation Performance and Phonograms Treaty
- Madrid Agreement Concerning the International Registration of Marks and Protocol to the Madrid Agreement
- Patent Cooperation Treaty
- Berne Convention for the
- Protection of Literary and Artistic Works Paris Convention for the Protection of Industrial Property
- Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations
- Convention for the Protection of Producers of Phonograms Against Unauthorised Duplication of their Phonograms

WHAT WE CAN DO FOR YOU

We at ATG have built our expertise over the past two decades assisting our clients to protect and growth their wealth through bespoke advice. We monitor developments in the EU and international trademark and IP stage and support our clients evaluating solutions as laws evolve. Each of our clients is provided with a tailored solution in line with their tax residency, the IP assets/rights involved and their specific circumstances.

We offer a full range of services for the exploitation and structuring of IP rights through Cyprus. Our intellectual property law team provide IP licensing, advisory, administration, compliance and exit / growth support. We have experience in all matters pertaining to the tax and legal implications of establishing a Cyprus IP solution including in-depth knowledge on trademark disputes and copyright law. **For a FREE Initial Consultation to discuss the specifics of your enquiry please contact Andreas Athinodorou on + 357 22057560 or andreas.athinodorou@atgcorporate.com**

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