On the 14th October 2016, the Cyprus Parliament approved the laws in relation to the amendment of the existing Cyprus Intellectual Property (IP) regime as published in the official gazette on 27th October 2016. The said amendments were made in order for the IP regime to be in line with OECD requirements Action 5 of the Base Erosion and Profit Shifting (BEPS) and have been incorporated in the Income Tax Law. The amendments are effective from the 1st July 2016 however there is five-year transitional period ie until the 30th June 2021 for those using the previous IP regime.

**Transitional rules**
The previous IP regime will continue to apply until 30 June 2021 in relation to IPs that qualified for the previous IP regime before the 2nd January 2016.
Under certain conditions however, transitional rules will also apply to IPs that were developed or acquired during the period 2 January 2016 through 30 June 2016 provided that:

- The IPs were acquired from a related party during that period
- the IPs qualified for the previous IP regime before the acquisition or qualified for a similar regime in another country and the IPs were not acquired for the main purpose of avoiding tax (in case this is not satisfied the provisions of the IP regime will apply only until the 31st December 2016)
- or the IPs were acquired from an unrelated party or were self-developed during the period 2 January 2016 through 30 June 2016

**New IP regime**
The new IP regime is in line with the OECD requirements and in effect gives an emphasis on research and development (R&D) of qualifying assets and the economic ownership.

In brief, under the new IP regime, a tax deduction equal to 80% of qualifying profits generated by qualifying assets will be applied by qualifying tax payers.

The qualifying profits are calculated by using the following ratio (the nexus fraction):

\[
\text{Qualifying profits} = \frac{\text{Overall income} \times \text{Qualifying expenditure} + \text{Uplift expenditure}}{\text{Overall Expenditure}}
\]
Qualifying profits
As shown in the ratio above, Qualifying profits means the proportion of the overall income corresponding to the fraction of the qualifying expenditure plus the uplift expenditure, over the total expenditure incurred for the qualifying assets.

Where the calculation of qualifying profits results in a loss, only 20% of this loss may be carried forward or group relieved in accordance with the provisions of Income Tax Law.

Overall income derived from qualifying assets is defined as the gross profit from the assets and includes amongst other:

- Royalties arising from the use of qualifying assets;
- Grant of a license for the exploitation of the qualifying assets;
- Insurance or compensation of the qualifying assets;
- Trading income from the disposal of the qualifying asset; and
- Embedded income on qualifying assets, which is derived from the sale of goods, the provision of services or use of any processes that are directly related to the qualifying assets.

Capital gains arising from the disposal of a qualifying asset under the new IP regime are not included in qualifying profits and are fully exempt from income tax.

Qualifying expenditure
Qualifying expenditure for qualifying intangible asset include, but are not limited to, the following:

- wages and salaries
- direct costs incurred wholly and exclusively for the production of income
- general expenses relating to installations used for R&D;
- expenses for supplies related to R&D activities
- costs associated with R&D that has been outsourced to non-related persons

However, the below expenditure is not considered qualifying expenditure:

- the acquisition cost of the assets
- interest paid or payable
- costs relating to the acquisition or construction of immovable property
amounts paid or payable directly or indirectly to a related person to conduct research and development activities, regardless of whether these amounts relate to cost sharing agreement

- expenditure that cannot be proved directly connected to a specific qualifying asset.

**Up-lift expenditure** means the lower of 30% of the qualifying expenditure and the total amount of the cost of acquisition of the qualifying asset and any costs incurred for R&D outsourced to related parties.

**Overall expenditure** of qualifying assets is the sum of (i) qualifying expenditure, and (ii) the total acquisition cost of the qualifying assets and any R&D costs outsourced to related parties incurred in any tax year.

**Qualifying assets**
Qualifying assets mean assets acquired, developed or exploited by a person in the course of his business, (excluding intellectual property associated with marketing), are the result of R&D activities and the qualifying taxpayer is the economic owner of the assets.

These assets can be:

- patents as defined in the Patents Law
- computer software
- other IP assets that are non-obvious, useful, and novel, where the person which utilizes them in the course of his business does not generate annual gross revenues exceeding Euro 7,500,000 (in case of a group of companies not exceeding Euro 50,000,000)

Business names (including brands), trademarks, rights to public presence, image rights and other intellectual property rights used to market products and services are not considered as qualifying intangible assets.

Qualified assets should be certified as “qualifying” by a Specialized Firm abroad.

**Qualifying taxpayers** that are eligible for the new IP regime include Cyprus tax resident persons, permanent establishments (PEs) of non-resident persons and foreign PEs that are subject to tax in Cyprus. The taxpayer can elect whether a foreign PE is taxable in Cyprus, so that the PE can be classified as a qualifying taxpayer.

**Maintaining books and records**
Qualifying taxpayers should maintain books and records for income and expenditure for each qualifying asset in order to accurately calculate the nexus fraction.
Other amendments
Capital allowances for all intangible assets (excluding goodwill and assets qualifying for the previous IP regime) are now allowable as a tax-deductible expense. Intangible assets will be amortised over the useful economic life of the asset, as determined by generally acceptable accounting principles (up to a maximum useful life of 20 years) and upon the disposal of such an intangible asset a balancing statement will be prepared (balancing addition being subject to income tax and any balancing deduction being tax deductible).

Conclusion
The new IP regime which is fully compliant with OECD requirements still remains very attractive resulting in an effective tax rate of 2.5%.

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