The Intellectual Property Box Regime in Cyprus

Cyprus is one of the most business-friendly countries globally. It ranks 54 among 190 countries listed by the World Bank for their ease of doing business. The island nation has strong and stable political and fiscal systems. This includes the usual EU benefits of numerous trade agreements, double-taxation treaties, and visa-free travel.

Apart from a welcoming business ecosystem and strong regulatory framework, businesses favour Cyprus for its Intellectual Property (IP) Box Regime. The country is an attractive destination for the establishment of an IP holding and development company, given its efficient corporate tax rates. The companies are also offered legal protection, afforded to all EU member states, as well as signatories of major IP treaties and protocols.

What is an IP Box Regime?

IP Box or Patent Box regimes are established by countries to encourage research and development regarding an IP asset. Most commonly, these assets include patents, software and copyrights. The companies are offered lower effective tax rates on income derived from IP. This income can include royalties, proceeds from the sale of IP, licensing fees, the sale of goods and services incorporating IP, and copyright infringement damage rewards.

Currently, 14 EU member states have an IP regime, including Cyprus. Non-EU countries like Switzerland and the UK also have one.

What Makes the Cyprus IP Regime Special?

Technological innovations have been at the heart of the Cypriot government's long-term development plans. Promoting a digital economy, by providing incentives to innovators and start-ups, is a top priority. The country is already home to several international technology companies, which have set up regional headquarters on the island and provide services to clients in Europe, North Africa and the Middle East. Despite the challenges of the pandemic, the Information, Communications and Technology (ICT) market in Cyprus reached a size of €113.16 million in 2020, growing 12.8% from the 2018 levels.

Supporting this growth is a robust and flexible IP taxation system, modernised in 2016. The system is fully compliant with the EU and international frameworks, including the OECD's Base Erosion and Profit Shifting Regime (BEPS) and the WIPO.

Highest Deduction Rate

In the regime, 80% of the qualifying profits are exempted from tax. Cyprus has a corporate tax rate of 12.5% but under the IP regime, the effective tax rate can be as low as 2.5%. In contrast, Hungary offers a deduction rate of 50%, while the Netherlands offers none.

Lowest Effective Tax Rate

So, Cyprus's IP Regime provides companies the lowest effective tax rate at 2.5%. This is much lower than Netherland's 9%, Turkey's 12.5%, Italy's 13.91% and France's 10%.

No Overall Deduction Limit

There is no overall deduction limit, compared to Belgium's 100% of pre-tax income.

0% Tax on Gains from Capital Nature Transactions

On July 17, 2020, a new bill was introduced by the Cypriot House of Representatives, amending Section 9(1)(I) of the Income Tax Law. This included several changes in the tax treatment of intangible assets. Applicable from January 1, 2022, if disposal of IP assets is by nature a capital transaction, the capital gain will not be taxable. The new bill has also abolished the need to prepare a balancing statement following such transactions.

Amortisation Period of Up to 20 Years

Development or IP acquisition expenses are amortised over 5 years, for up to 20 years. This can lower the effective tax rate to less than 2%.

Wider Range of Qualifying Revenue

Compared to other European regimes, the Cyprus IP Box Regime applies to a wider range of income. Most of the regimes don't include income from patents and supplementary patent certificates. Other countries also have limitations on qualifying assets.

Apart from all these benefits, companies enjoy the benefits of a strategic location in the EU, and Cyprus's double tax treaties with around 50 countries. This means that IP owners can capitalise on rights in multiple countries.

Relevant Details of the IP Box Regime

The new regime adopts the "Nexus" approach to calculating qualifying profits. This means the level of qualifying profits is directly related to the extent the company (claimant) invests in R&D activities to develop the qualifying asset. Under the regime, 80% of the qualifying profits generated from the qualifying assets is a tax-deductible expense.

What are Qualifying Assets?

Under the new regime, Qualifying Assets (QA) include:

- Patents
- Copyrighted software programs
- Non-obvious, useful and novel intangible assets.

These don't include trademarks and other IP rights involved in marketing products and services that do not fall under qualifying intangible assets.

Qualifying Profit (QP) Under the Regime

The nexus fraction calculation of the Qualifying Profit is as follows:

QP = OI X (QE+UE)/OE

Where:

OI = Overall income from the QA

QE = Qualifying expenditure on the QA

UE = Uplift expenditure on the QA

OE = Overall expenditure on the QA

Who are Qualifying Persons or Establishments under the Regime?

Qualifying Persons (QPs) or establishments include:

- Cypriot tax residents
- Tax resident permanent establishments (PEs) of non-tax residents
- PEs from foreign countries who have agreed to be subjected to tax in Cyprus.

Steps to Register and Garner Benefits of the Regime

Any IP owner has to choose a suitable jurisdiction to set up their business. Cyprus offers a favourable IP jurisdiction.

To access benefits of this regime, companies need to follow a few steps, which include:

- **Set Up a Cyprus Based Company**: Companies have to set up base in Cyprus. Registering a company under Cypriot law is easy and faster than in many other EU countries. This can be done remotely, with the help of legal representation.
- **Transfer of Ownership**: The IP ownership has to be transferred to the newly established company.
- **Licensing of Rights:** The Cyprus company can license the rights to use the IP to any other company.
- **Patent Box Structure:** The company needs to seek legal advice to organise the patent box structure. There will also be a need to prepare legal agreements.

After this, any income the IP owner receives will apply to a minimum effective tax rate of 2.5%.

Cyprus offers an efficient IP tax regime and maximum certainty for owners due to the ratification of major IP treaties and protocols. Companies should consult legal experts to learn about their rights in detail.