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Changes to IP box scheme proposed

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Corporate Tax, Cyprus

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Introduction

Parliament recently amended the Income Tax Law to bring its provisions on the taxation of income from the use or sale of intangible assets into line with the 'modified nexus' approach.

This approach was agreed by G20 leaders towards the end of 2014 and adopted by the Organisation for Economic Cooperation and Development and the European Union. It allows a taxpayer to benefit from an IP taxation regime (commonly known as an 'IP box') to the extent that it can show material relevant activity, including a clear connection between the rights which create the IP income and the activity which contributes to that income.

Countries whose IP regimes were incompatible with the modified nexus approach were required to amend them and to allow no new entrants to non-compliant IP regimes after June 30 2016. However, transitional arrangements allowing taxpayers benefiting from existing schemes to continue to do so until June 30 2021 were permitted.

In January 2016 the Ministry of Finance announced that it would modify the Cyprus IP box in order to conform with the modified nexus approach. The new law and the detailed regulations submitted to Parliament for approval fulfil this commitment.

Transitional arrangements

The existing IP box regime, which was introduced in 2012, provides an 80% tax exemption on income from the use of a wide range of intangible assets. Coupled with Cyprus's low corporate income tax of 12.5%, it gives an effective tax rate on such income of 2.5% or less.

Taxpayers already benefiting from the existing scheme may continue to claim the same benefits until June 30 2021, subject to certain conditions regarding assets acquired between January 2 2016 and June 30 2016.

New arrangements

The arrangements for assets developed after July 1 2016 follow the modified nexus approach. Qualifying assets are restricted to patents, software and other IP assets which are legally protected. IP rights used to market products and services – such as business names, brands, trademarks and image rights – do not fall within the definition of 'qualifying assets'. Relief is geared to the cost incurred by the taxpayer in developing the intellectual property through its research and development activities. The following are excluded from the definition of 'qualifying expenditure':

- the purchase costs of intangible assets;
- interest;
- costs relating to the acquisition or construction of immovable property; and
- amounts paid or payable, directly or indirectly, to a related party.

As was the case under the existing scheme, 80% of the overall profit derived from a qualifying intangible asset is treated as a deductible expense, preserving the effective tax rate of less than 2.5% on such income.

Comment

The transitional arrangements secure the existing generous benefits for intellectual property developed before June 30 2016 until June 30 2021. While the range of assets and categories of expenditure that qualify for relief after July 1 2016 are more restricted than under the previous rules, Cyprus's IP box still represents an attractive option for taxpayers, with an effective tax rate of less than 2.5% on qualifying income.

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