



Philippos Aristotelous

New tax relief for investors in small and medium-sized innovative enterprises



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Corporate Tax, Cyprus

The Income Tax (Amendment) (No 2) Law 2016 (135(I)/2016) introduces new tax relief for investors in qualifying small and medium-sized innovative enterprises. The amendment law adds a new Section 9A to the Income Tax Law 2002, allowing independent investors in such enterprises to deduct the cost of the investment from their taxable income for the year in which the investment was made. The deduction is limited to 50% of the investor's taxable income for the year or €150,000, whichever is less. Any cost above the 50% limit may be carried forward for deduction against the investor's taxable income of subsequent years, subject to a 50% limit, for a maximum of five years. In order to qualify for relief, an investor must retain the investment for at least three years.

An independent investor in an existing company is one that is not already a shareholder of the company concerned. In a newly incorporated company, all of the founding investors are treated as independent. Investments may be made directly or via an investment fund or a venture capital investment platform, and they may include loans, subject to specified conditions. With regard to follow-on investments, the conditions established in Article 21(6) of EU Regulation 651/2014, which declare certain categories of aid compatible with the internal market, must be satisfied. Relief may be withheld if the tax authorities consider that transactions have been carried out to obtain relief and circumvent limits established by law.

In order to be a qualifying investment, the investee company must be a small or medium-sized innovative enterprise that conducts business in Cyprus and meets the conditions established in Article 21(5) of EU Regulation 651/2014 – namely, it must:

- be an unlisted company not operating in any market; or
- if operational, have operated for less than seven years, requiring an initial risk finance investment which, based on a business plan prepared in view of entering a new product or geographical market, is higher than 50% of the company's average annual turnover for the preceding five years. The seven-year limit does not apply to follow-on investments, subject to certain conditions.

Designation as a small or medium-sized innovative enterprise requires Ministry of Finance approval. In order to obtain approval, the company must provide confirmation from an external auditor that research and development costs, as recognised by international accounting standards, account for at least 10% of its total operating costs.

Under Annex 1 of EU Regulation 651/2014, in order to qualify as a small or medium-sized enterprise a company must have:

- fewer than 250 employees;
- an annual turnover not exceeding €50 million; and
- an annual balance sheet total not exceeding €43 million.

The new provisions took effect on January 1 2017 and will expire on January 1 2020, unless extended.

For further information on this topic please contact Philippos Aristotelous at Andreas Neocleous & Co LLC by telephone (+357 25 110 000) or email (aristotelous@neocleous.com). The Andreas Neocleous & Co LLC website can be accessed at www.neocleous.com.

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