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# Cyprus intellectual property rights box

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Introduced in 2012, the Cyprus intellectual property rights box regime offers a range of tax incentives and exemptions for the creation and exploitation of intellectual property. The scheme contrasts favourably against similar regimes in other European jurisdictions, providing significant advantages.

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In May 2012, as part of a package of measures aimed at stimulating the island's predominantly service-oriented economy and promoting economic growth, the Cyprus government introduced an array of incentives and exemptions relating to investment in intellectual property rights, commonly known as an intellectual property rights box ("IP box").

The concept of the IP box dates back to 2001, when France introduced a reduced rate of tax on revenue or gains deriving from the license, sublicense, sale, or transfer of qualifying IP. Since then, Belgium, Hungary, Ireland, Luxembourg, Netherlands, Spain and the United Kingdom have also introduced similar schemes. The underlying rationale is to stimulate investment into the research and development sector by providing tax incentives, which governments justify on the grounds that the successful innovation that results creates benefits for the public at large that compensate for lost tax revenue.

IP box regimes can be broadly divided into two categories. The first (adopted by France, the Netherlands and the United Kingdom) provides for qualifying revenue to be taxed at less than the standard rate. The second category (adopted by Belgium, Cyprus, Hungary, Luxembourg and Spain) exempts a specified proportion of revenues. This second category further subdivides into schemes that exempt a proportion of gross revenues and those that exempt a proportion of net revenues.

Intellectual property is an increasingly important element in the value of modern-day businesses and intellectual property projects lend themselves to cross-border planning by reason of the mobility of intellectual property rights, which do not consist of physical assets and so can be easily moved between different jurisdictions and tax systems according to prevailing circumstances and developments. By introducing the IP box Cyprus hopes to consolidate its position as a hub for the cross-border holding and exploitation of intellectual property rights.

The Cyprus exemptions, which took effect from January 1, 2012, apply to all expenditure for the acquisition or development of intangible assets incurred by a person carrying on a business. They apply to all categories of intellectual property, including the rights set out in the Patent Law of 1998 as amended, the Intellectual Property Rights Law of 1976 as amended and the Trademarks Law, Cap. 268 as amended.

## Principal features of the Cyprus IP box

The main features of the Cyprus IP box are as follows.

### 5-year amortisation period

The cost of acquisition or development of an IP right acquired by a Cyprus company may be capitalised and written off on a straight line basis over 5 years, giving an annual writing down allowance of 20 percent.

Previously, amortisation rates were determined by reference to the estimated useful life of the underlying asset. For example, if a patent had a term of 20 years its useful life would be deemed to be 20 years and the writing down allowance would be 5 percent per year.

The acceleration of writing down allowances will significantly defer tax liabilities and bring substantial cash flow benefits, particularly for larger items.

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#### 80 percent deduction of revenue from exploitation of IP rights

Eighty percent of the profit earned from the use of intangible assets (including any compensation for infringement of intellectual property rights) is deducted for tax purposes. Therefore, only 20 percent of IP income after deduction of the costs of earning the income (including amortisation), is taken into account.

Since Cyprus's corporate tax rate is 12.5 percent, which is among the lowest in the EU, the maximum rate of tax on income generated by IP assets is 2.5 percent. This is half the rate offered by the next most attractive scheme (the Netherlands). However, given that expenses, including amortisation, are fully deductible from the IP income, the effective rate in most cases will be below 2.5 percent.

In the event that IP-related costs and deductions exceed revenue earned from IP assets, the loss may be offset against other income for the year or carried forward.

#### Tax exemption of dividends resulting from IP activities

Any dividend income generated out of royalty income earned by a Cyprus company and paid to its non-resident shareholders is exempt from Cyprus tax of any description.

#### 80 percent deduction of profits on disposal of IP rights

The 80 percent exemption applies not only to income derived from intellectual property assets, but also to any gains on disposal of the assets. Eighty percent of any profit resulting from the disposal of relevant intangible assets is disregarded for tax purposes.

While this is a more generous exemption than is available under any competing regime, for most disposals an even greater tax saving can be achieved by holding the assets concerned in a separate company and disposing of the shares in that company, rather than the IP assets themselves. This option would result in full exemption of the gain, as well as stamp duty savings, since gains on disposals of qualifying securities (which includes shares) are exempt from all forms of taxation in Cyprus except to the extent that they derive from the disposal of immovable property located in Cyprus.

### Comparison with other European IP box regimes

The table below summarises the key differences between the main IP box regimes:

| | Cyprus | Belgium | France | Hungary | Luxembourg | Netherlands | Spain | UK |
|---|---|---|---|---|---|---|---|---|
| Effective tax rate | 2.5% | 6.8% | 15% | 9.5% | 5.76% | 5% | 15% | 10% |
| Qualifying IP assets | All IP assets, including patents, trademarks, copyright, formulas, designs, know-how and processes. | Patents and supplementary protection certificates. | Patents, extensions, patentable inventions and industrial fabrication processes | Patents, know-how, trademarks, business names, know-how and copyrights | Patents, trademarks, designs, domain names, models and software copyrights | Self-developed IP relating to patents or approved R&D. | Patents, formulas, processes, plans, models, designs and know-how | UK and European patents, supplementary protection certificates and plant variety rights |
| Ineligible IP assets | None | Know-how, trademarks, designs, models, formulas or processes | Acquired IP rights held for less than 2 years | None | Know-how, formulas, copyrights (other than software), | Trademarks and brands; acquired IP | Trademarks, copyrights of literary, artistic, or scientific work, including software | Trademarks, copyrights and designs |
| Internally developed or acquired? | Applies to both internally developed and acquired IP | Internally developed IP and improvements to acquired IP | Applies to both internally developed and acquired IP | Applies to both internally developed and acquired IP | Applies to both internally developed and acquired IP, but not IP acquired from a related party | Self-developed only | Self-developed only | Self-developed and "actively managed" (used in business) only |
| Limitations on where R&D takes place | None | Some | None | None | None | Some | Some | None |
| Qualifying revenue | All income, including compensation for breach of rights, net of costs | Patent income | Royalties net of cost of managing qualifying IP | Royalties | Royalties net of costs (amortization, R&D costs, interest etc) | Net income from qualifying assets | Gross income from qualifying assets | Net income from qualifying IP |

| | Cyprus | Belgium | France | Hungary | Luxembourg | Netherlands | Spain | UK |
|---|---|---|---|---|---|---|---|---|
| Deduction rate | 80% | 80% | None — reduced tax rate | 50% | 80% | None — reduced tax rate | 50% | None — reduced tax rate |
| Overall limit of deduction | None | 100% of pre-tax income | None | 50% of pre-tax income | None | None | 6x the cost of developing the IP | None |
| Gains on disposal included | Yes | No | Yes | Yes | Yes | Yes | No | Yes |

As noted above, the maximum rate of tax payable in Cyprus on income earned from IP assets is 2.5 percent. The comparable rate in its nearest competitor, the Netherlands, is double that amount, at 5 percent. Luxembourg (5.76 percent) and Belgium (6.8 percent) are close behind the Netherlands but far behind Cyprus.

What is more, the Cyprus IP box regime exempts a much wider range of income than any other. It covers income from all IP assets, of whatever nature, whether internally developed or acquired from third parties, regardless of the location in which any research and development takes place. Most other countries' schemes restrict benefits to income from specified categories of intellectual property such as patents and supplementary protection certificates, and exclude major categories such as trademarks, know-how and copyrights. For example, the Netherlands scheme exempts only income from self-developed IP relating to patents or approved R&D. Income from acquired patents or from other forms of intellectual property apart from patents does not enjoy any exemption. In addition, there is no cap on benefits, such as applies in Belgium, Hungary and Spain.

While the French, Hungarian, Luxembourg, Netherlands and United Kingdom schemes offer partial exemption of gains on disposal, the exemptions are less attractive than those provided by the Cyprus scheme, due to limitations on qualifying assets and less generous deduction rates. Furthermore, full exemption can be relatively easily obtained in Cyprus by holding the IP assets in a separate company and disposing of the shares in the company, as described above.

In most areas, choice of an appropriate jurisdiction involves trade-offs and compromises. One jurisdiction will be better on certain aspects, but another will be better on others, and the differences will have to be assessed and weighed against one another to arrive at the best overall solution. In the case of the IP box regime there is no need for this since, as the table demonstrates, Cyprus is the clear leader in every measure.

## Cyprus IP structures

Before introduction of the IP box regime, a Cyprus licensing arrangement would typically involve a company in a low tax jurisdiction (the IP owner) which licensed the use of its IP rights to a Cyprus company established for the purpose of acting as an intermediary licensing vehicle. This latter company would sublicense the right to exploit the IP rights to another entity, usually registered and tax resident in a country with a double tax treaty with Cyprus. The royalty fees charged by the IP owner would usually be around 90 percent of the royalty income generated by the Cyprus company, leaving a 10 percent margin subject to Cyprus tax.

However, following the introduction of the IP box, there is no longer a need for a separate IP owner since the Cyprus company can fulfil this role. This will provide substantial tax savings and planning opportunities, and reduce administrative and compliance costs also by eliminating unnecessary bureaucracy.

The Russian tax authorities are now challenging structures involving back-to-back royalty schemes. Cyprus offers a much less vulnerable alternative without any loss of tax savings.

For example, a Cyprus company can hold the IP asset and enter into licensing agreements with entities located in jurisdictions accessible to low withholding tax rates, whether via a double tax agreement or the EU Interest and Royalties Directive, which provides a uniform tax regime for royalties paid throughout Europe. Cyprus has an extensive network of double tax treaties and is also a member of the EU, giving Cyprus resident companies the benefits of the Interest and Royalties Directive. Cyprus is therefore an ideal location for the establishment and maintenance of the IP owner which will generate royalty income that will be substantially exempt from taxation in Cyprus. There will no longer be any need to maintain a structure involving entities in several jurisdictions, with the costs that that entails.

## Conclusion

As the table above demonstrates, Cyprus is the clear European leader on every aspect of its IP taxation regime. It offers the lowest effective rate of tax, includes the widest range of IP assets and imposes the fewest restrictions and limitations.

In most cases immediate economic and tax savings can be accomplished by transferring intellectual rights currently held by entities located in low or no tax jurisdictions to Cyprus resident companies in order to take advantage of the new exemptions. The transfer of IP rights into a Cyprus company will not attract any form of direct taxation in Cyprus and the new benefits and substantial exemptions will become available as soon as the asset is transferred.

The Cyprus IP box provides attractive opportunities for structuring the exploitation of IP assets through Cyprus and in particular through the use of Cyprus-resident IP owners, especially in conjunction with Cyprus's extensive network of double tax treaties, under




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which withholding tax on royalty income is either eliminated altogether or substantially reduced.

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