Corporate Tax - Cyprus

New IP rights box provides income tax law exemptions

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Introduction

Towards the end of May 2012, as part of the government's programme to stimulate the economy, Cyprus amended its income tax laws to introduce a series of incentives and exemptions relating to income from IP rights, commonly known as an IP rights box. The amendments are effective from January 1 2012 and apply to all expenditure for the acquisition or development of intangible assets incurred by a person carrying on a business, including all categories of intellectual property.

The concept has already been successfully implemented in other EU member states, including Luxembourg, the Netherlands, Ireland and, most recently, the United Kingdom. The underlying rationale is to encourage investment, particularly inward investment, in research and development by providing tax incentives.

IP projects are ideal for cross-border planning due to the mobility of IP rights, which can easily be moved between different jurisdictions and tax systems according to prevailing circumstances and developments in different tax jurisdictions. By amending its tax legislation, Cyprus hopes to consolidate its position as a hub for the cross-border holding and exploitation of IP rights.

Main changes

Five-year amortisation period
Following the amendments, the cost of acquisition or development of an IP right acquired by a Cyprus company may be capitalised and amortised on a straight-line basis over five years.

This is a considerable improvement on the previous regime, in which amortisation rates were determined on the basis of the estimated useful life of the underlying asset. For example, if a patent had a validity of 20 years, its useful life would be deemed to be 20 years and the write-down allowance would be 5% a year.

The deferral of tax liabilities resulting from the acceleration of write-down allowances will result in substantial cash-flow benefits, especially where the value of the IP asset is substantial.

Exemption of profits from exploitation of IP rights
Four-fifths of the profit earned from the use of intangible assets (including any compensation for infringement) is disregarded for tax purposes.

Furthermore, any dividend income generated out of royalty income earned by a Cyprus resident company and paid to non-resident shareholders is completely exempt from Cyprus tax of any description. This makes Cyprus the ideal location for a structure involving a company generating royalties under licensing or similar arrangements with third parties and subsequently distributing profits in the form of dividends to its shareholders.

Exemption of gains on disposal of IP rights
Four-fifths of any gain resulting from the disposal of relevant intangible assets is disregarded for tax purposes.

While this exemption is not to be dismissed, in most cases it is possible to obtain complete exemption from the taxation of gains on disposal by holding the assets concerned in a separate company and disposing of the shares in that company, rather than the assets themselves, since gains on the disposal of qualifying securities 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.

Low effective tax rate
The amount subject to tax under the new rules is calculated after deducting amortisation of the assets, interest costs of financing the acquisition or development of the assets and any other direct expenses, and dividing the resultant amount by five. Applying the Cyprus corporate income tax rate of 10% - the lowest in the European Union - produces an effective tax rate of 2% of net income. Given the generous deductions that are available against gross income, the effective rate should generally be well below 2%.

This compares very favourably with the competition - the United Kingdom's optional new patent box regime gives an effective rate of 10% on relevant income. The effective tax rates under the Luxembourg and Netherlands schemes are lower, at 5.76% and 5% respectively, but they are still both more than double the Cyprus rate.

Simplification of structures
There are other benefits apart from the direct savings on tax. The new regime enables the IP asset to be owned and licensed by a Cyprus resident company and obviates the previous need to have a company in a low-tax or no-tax jurisdiction - such as the British Virgin Islands - as the owner, with the Cyprus company as an intermediary licensing company. This will enhance legal and jurisdictional protection and eliminate unnecessary costs and bureaucracy.

Comment

In most cases, immediate savings can be achieved by transferring IP 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 give rise to no form of taxation in Cyprus and the new benefits and exemptions will become available as soon as the asset is transferred.

The new regime provides very attractive opportunities for structuring the exploitation of IP assets through Cyprus and, in particular, through the use of Cyprus-resident IP owners, especially in the context of Cyprus's extensive network of double tax treaties, under which overseas withholding tax on royalties remitted to Cyprus is either eliminated altogether or substantially reduced.

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