

RELEVANT TO ACCA QUALIFICATION PAPER P6 (CYP)

Understanding the new legislation regarding intellectual property

Following a number of amendments to Cyprus tax legislation, there have been significant changes to the *Study Guide*. The amendments to legislation are a result of measures to combat tax evasion and to increase government revenue, as well as new incentives to make the tax system more attractive. In a previous article, '[Amendments to the Paper P6 \(CYP\) syllabus](#)', I listed the main changes and gave a brief description of each. In certain cases, I stated that a technical article will be issued to help explain the change.

This is the third in a series of articles written for this purpose, and expands on point A(3)(d) of the aforementioned article. It explains the tax treatment of the new intellectual property regime for Cyprus tax-resident companies. In order to appreciate the application of this legislative change, a wider understanding of the legal background is provided, but candidates are not expected to be aware of this (see Section 2 below). Candidates will be expected to be familiar with the tax provisions stated within this technical article (see Sections 3 and 4 below). Candidates are never expected, or required, to make specific references to articles of the tax legislation.

1 Explanation of the intellectual property amendment

Cyprus has enacted its own 'patent box' regime for intellectual property (IP) for profits derived from IP. This follows that of a number of other countries including the UK, Spain, France, China, Switzerland, Luxembourg, Belgium, the Netherlands and Ireland. The purpose of each patent box regime is to create a low tax environment in order to attract research and development activities, as well as to promote innovation and investment in new technology. The more tax favourable box regimes in existence have an effective rate of 5%. Cyprus has come in strong with a **maximum** effective rate of 2%, and in most cases, even lower.

Article 9 of the Income Tax Law of Cyprus discusses what expenses are deductible in arriving at taxable profits. An amendment to Article 9 was introduced during 2012 with regards to IP rights. With the amendment, the Republic of Cyprus constitutes a leading jurisdiction for businesses planning for intellectual property income.

This tax update analyses this matter. A circular is expected from the Cyprus Income Tax Office (ITO) on this topic, which will clarify certain points, but at the time of writing this article it has not yet been published.

2 Legal framework

Cyprus has a sound legal framework based on the English legal system, the principles of common law and equity. The Cyprus legal system has been

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developed to ardently safeguard IP rights. This is not only evident at a national level, but membership of the European Union and the conclusion of numerous international conventions, provide IP protection at European and international levels too.

The three categories of IP are:

- patents,
- trademarks, service marks and designs, and
- copyrights.

Legal protection is afforded as follows:

Patents

Under the Patent Law 16(I)/98, any person or organisation may submit to the Registrar of Companies and Official Receiver, an application for a new invention, providing them with a national patent certificate.

The Registrar's Department of Intellectual and Industrial Property also registers and protects patents granted by the European Patent Office (EPO). As such, a European patent certificate can also be granted.

In addition to the above, the Registrar of Companies acts as a receiving office for European (EPO) and international (under the Patent Cooperation Treaty (PCT)) applications of patents, offering international patent protection. The PCT is administered by the World Intellectual Property Organisation (WIPO), of which Cyprus is a member.

Trademarks, service marks and designs

At a national level, protection of trademarks, service marks and designs is afforded through registration in accordance with the Trademarks Law Cap 268. Protection of trademarks is afforded under the legislation both for Cyprus registered owners as well as for foreign owners.

Cyprus also offers EU and international protection through enforcement of applicable EU Regulations and international conventions.

Copyrights

The Protection of Intellectual Property Law 59/76 offers protection at a national level.

Furthermore, Cyprus is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, administered by WIPO. The Berne Convention is an international agreement governing copyright.

3 Tax Incentives

Application of the tax incentives

The tax incentives extend to the three categories of IP:

- patents (as defined in Patent Law 16(I)/98),
- trademarks, service marks and designs (as defined in Trademarks Law Cap 268), and
- copyrights (as defined in Protection of Intellectual Property Law 59/76)

If the IP does not fall in one of the above categories, as defined in Cyprus legislation, it will not be entitled to the specific IP tax benefits. Goodwill does not constitute IP.

The law applies to IP acquired or developed on or after 1 January 2012. The tax incentive applies also to any damages received by the IP owner for illegal use of the IP.

Analysis of the tax position

Any expense for the purchase or the development of IP, as defined above, is tax deductible. However, in instances where this expense is of a capital nature, then this cost is amortised over a period of five years, starting in the year of purchase/development. The amortisation allowance is tax deductible. These accelerated amortisation allowances will normally give full tax relief of the cost over a much shorter period of time (five years) than the IP's useful economic life.

In addition, a statutory deduction is automatically provided, equal to 80% of the **profit** (see below for definition of profit) from the use of the IP, as well as from any gain on the sale of the IP. The remaining amount will form part of the taxable profits of the company and be taxed at the corporation tax rate of 10%.

Further tax reductions can apply if the shares of the company owning the IP are sold, instead of the company selling the IP itself. In this case, no tax will apply given that in Cyprus the gain from the sale of shares is tax exempt (assuming the Cyprus company holds no immovable property based in Cyprus).

Profit is arrived at, following the deduction of any direct expenses incurred in making the profit.

This means that the maximum effective tax rate is 2%.

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Example 1

A Cyprus tax-resident company purchases a patent for €750.000 on 1 June 2013. During 2013, it incurs direct expenses of €10.000 relating to the patent, but receives royalty income equal to €200.000 from its use.

The taxable income of the company relating to the IP for 2013 will be as follows:

	€
Royalty income from patent	200.000
Less direct costs	(10.000)
Less amortisation allowance (being 20% of cost €750.000)	<u>(150.000)</u>
Profit	40.000
Less 80% statutory deduction (80% x €40.000)	<u>(32.000)</u>
Taxable profit	8.000
Tax at 10%	<u>800</u>
Effective tax rate	<u>0,4%</u>

Example 2

Continuing from *Example 1*, the company sells the patent in 2015 for €1.500.000. It paid €100.000 finders commission. The proceeds from the disposal will be taxed as follows:

	€
Income from sale of patent	1.500.000
Less – cost of acquisition	(750.000)
Less – commission payment	<u>(100.000)</u>
	650.000
Add back amortisation allowance claimed in 2013 and 2014 (2 x €150.000)	<u>300.000</u>
Profit / Gain	950.000
Less 80% statutory deduction (80% x €950.000)	<u>(760.000)</u>
Taxable profits	<u>190.000</u>
Corporation tax at 10%	<u>19.000</u>
Effective tax rate	<u>1,27%</u>

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Note: the ITO has signalled that it will interpret the legislation so that the amortisation allowance should reduce the cost (ie be added back) in arriving at the profit before the statutory deduction. This is not widely accepted as being in accordance with the strict interpretation to the provisions of the legislation. We are awaiting the ITO's circular in order to understand their definitive position. In the meantime, candidates will be expected to follow the ITO's interpretation in the computations, as shown in Example 2 above.

4 Other consideration

Value added tax (VAT)

The Cyprus company may require VAT registration in Cyprus. It may, in any case, be beneficial to voluntarily register for VAT if no registration obligation exists.

Income from royalties is a service and – under VAT legislation – the place of supply of royalty services, when the transaction is business-to-business (B2B), is where the supplier is located. If the Cyprus company provides royalty services to taxable persons in other EU countries, it will need to register for VAT in Cyprus in order to declare such services on its monthly VIES declaration. Moreover, a registration requirement may also arise on the purchase of the IP by a Cyprus company.

However, VAT registration will result in administration formalities but, if structured correctly, should not give rise to a VAT cost for the Cyprus company.

Withholding taxes

Cyprus applies no withholding taxes on royalty payments made from Cyprus, except in the case where the IP right is exploited in Cyprus. Moreover, Cyprus has entered into numerous double tax treaties, most of which reduce or eliminate any withholding tax on royalties received by the Cyprus company.

This strengthens Cyprus's position as a prime jurisdiction for IP tax planning.

Cyprus International Trusts

The new IP regime can be combined with a Cyprus International Trust, used as the financing and/or holding vehicle for the Cyprus IP-owning company. The resulting interest and/or dividend income will be received without any tax leakage, so long as the beneficiaries are not Cyprus tax residents.

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