Tax and VAT considerations for companies holding Intellectual Property in Cyprus

Introduction

An increasing number of companies choose Cyprus as the location to hold and manage their Intellectual Property ("IP"). These include technology companies, but also other organisations which own patents, trademarks, trade secrets, copyrights in literary and artistic works, computer software, and other inventions.

Cyprus has proven to be an ideal jurisdiction for the establishment of their IP structures, providing them access to the required sources to meet their business's objectives, safeguarding and protecting their IP assets, and offering an attractive tax regime which allows them to manage and exploit their IP assets in a tax efficient manner.

Tax benefits available to IP companies under the IP regime

The Cyprus IP regime enables IP companies to achieve a low effective tax rate by providing exemptions from tax on income related to IP. More specifically,

- 80% of the "Qualifying Profits" generated from "Qualifying Assets" is deducted for tax purposes, reducing the effective tax rate on IP assets to as low as 2.5%. For more details click **here**.

- No tax is imposed on the disposal of a "Qualifying Asset", provided that the disposal is of capital nature.

Tax benefits available to IP companies (irrespective of the IP regime)

But even in cases where an IP company cannot benefit from the tax benefits of the IP regime, either because the IP asset is not a Qualifying Asset or for other reasons (e.g., significant R&D work assigned to related parties), it can still achieve low effective taxation due to the following tax incentives:

Capital allowances

All intangible assets (excluding goodwill), irrespective of whether they are qualifying assets or not, are eligible for tax amortisation over their useful economic life with a maximum of 20 years.

Notional Interest Deduction (NID)

NID is a notional deduction, available to companies employing IP assets in the production of taxable revenue (e.g. royalties) that have been funded out of new equity financing. The NID cannot exceed 80% of the taxable profit generated from the IP assets and can potentially reduce the effective tax rate to as low as 2.5%. For more details, click **here**.

"Super" deduction for R&D expenses

Expenditure for scientific research incurred by a person carrying on any business, as well as R&D expenses carried out by small and medium-sized innovative companies, are deductible from taxable income if they were wholly and exclusively incurred to produce income. For expenses incurred during the years 2022, 2023 and 2024, including expenses of a capital nature, companies can enjoy an additional tax deduction of 20% for R&D expenses. Effectively, 120% of the actual eligible R&D expenses will be deducted from taxable income.

What should a company consider when establishing its IP structure to achieve the maximum tax benefit from the IP Regime?

Economic owner of Qualifying Asset

For a company to qualify for the tax benefits of the Cyprus IP regime, it must be the economic owner of the "Qualifying Asset", meaning that it should bear the risks and rewards from its exploitation.

Research, development and acquisition costs

The higher the Research & Development ("R&D") expenditure incurred by the company to develop the IP assets, the higher the amount of the profits qualifying for the 80% tax exemption. This may also include R&D work outsourced to non-related parties.

The higher the acquisition cost and the R&D costs carried by related parties, the lower will be the "Qualifying profits" subject to the 80% exemption. However, provided that the total of any acquisition cost and R&D work subcontracted to related parties do not exceed 30% of the R&D expenditure incurred by the company itself, a company can still achieve the maximum IP benefit.

Challenges and obligations of IP companies claiming the IP exemption

In cases where the income earned by a company from the sale of goods, provision of services or use of any processes is directly related to "Qualifying Assets", such income may include an element of embedded income, connected with the right to use of the "Qualifying Asset". In order to claim a tax exemption on such embedded income, a Transfer Pricing (TP) study in accordance with the OECD TP guidelines must be prepared to determine such element.

A company is required to keep track of the relevant income and expenditure per "Qualifying Asset" in order to accurately calculate the nexus fraction and the "Qualifying Profits". In addition, it is important that expenditure incurred for R&D or associated with R&D activities is explicitly identified. This maybe challenging as the tax legislation does not provide a precise definition of R&D for the purpose of the nexus fraction calculation.

VAT considerations and challenges in relation to IP assets held in Cyprus

VAT considerations

The supply of an IP asset is considered as a supply of services for VAT purposes and follows the general rules for the place of supply of services.

The acquisition of an IP asset and/or R&D services by a company/individual who is established/located in Cyprus, from foreign suppliers with the intention to exploit the IP asset and derive income, would result in the company/individual being considered as a taxable person for VAT purposes, triggering a potential registration obligation and VAT compliance requirements.

VAT challenges

Depending on the way that the taxable person chooses to exploit the acquired/developed IP asset and the type(s) of income that they it will derive, proper assessment should take place to determine the appropriate VAT treatment.

Considering that nowadays the exploitation of the IP assets usually takes place on a multinational level, it is important to ensure that the taxable person adheres not only to the local VAT requirements, but also to foreign VAT requirements.

Conclusion

Any decision for the management of IP structures including the development, holding and exploitation of your IP requires careful consideration of all the relevant facts and circumstances, to maximise the financial benefits and mitigate potential risks. The key is to find the right solution that suits your needs without disruption to your business. It is thus imperative to request tailored consultation prior to taking any decisions

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