

Implementing Regulations of the IP Regime

Further to our Newsletter Issue 06/2016, we would like to inform you that the House of Representatives has voted the Implementing Regulations in relation to the new Cyprus Intellectual Property (IP) Regime.

The Regulations include amongst others:

- 1. The definition of Qualifying Intangible Asset*
- 2. The definition of Qualifying Profits and of the Modified Nexus approach fraction*
- 3. The definition of Qualifying taxpayers*

1. Qualifying Intangible Asset

A Qualifying Intangible Asset is an asset which was acquired, developed or exploited by a person in the course of exercising its business and constitutes an IP (excluding any IP which relates to marketing) which is a result of Research and Development (R&D) and includes also intangibles for which there is only economic ownership.

Qualifying intangible assets consist of:

- i) patents, as these are defined in the Patents Law*
- ii) computer software*
- iii) other intangible assets that are legally protected and fall under the provisions of the below sub-paragraphs:*
 - a. utility models, intellectual property assets which provide protection to plants and genetic material, orphan drug designations and extensions of patent protections, or,*
 - b. IP assets which are non-obvious, useful and novel for which the gross income of the person who exploits them in the course of its business does not exceed, in a 5 year period,*

the average amount of EUR 7.5m per annum (or EUR 50m for taxpayers forming part of a Group) and are not trade names, including brands, trademarks or image rights of intellectual property used in the trading of goods and services.

It is noted that the Qualifying Intangible Asset should be certified as such, by the responsible body of the Republic or the foreign country.

2. Qualifying Profits

The Qualifying Profits are calculated based on the below formula:

$$\frac{(QE+UE) *OI}{OE}$$

where,

QE is the qualifying expenditure on the Qualifying Intangible Asset,

UE is the Up-Lift expenditure

OE is the Overall Expenditure on the Qualifying Intangible Asset

OI is the Overall Income derived from the Qualifying Intangible Asset

a) Qualifying Expenditure (QE)

The Qualifying Expenditure of a Qualifying Intangible Asset, is the sum of all R&D expenditure which was incurred during any tax year wholly and exclusively for the development, improvement, or generation of the Qualifying Intangible Asset and which relates directly with the Qualifying Intangible Asset

The QE includes, inter alia, the following:

- i) wages and salaries
- ii) direct costs
- iii) general expenses related with R&D activities
- iv) expenditure on commissions which relate to R&D
- v) expenditure on R&D which is outsourced to non-related parties

but, does not include:

- i) the cost of acquisition of the intangible asset
- ii) interest paid or payable
- iii) cost related to the acquisition or construction of immovable property
- iv) amounts paid, or are payable directly or indirectly, to a related party for carrying out R&D activities, irrespective on whether the amounts relate to an agreement for apportionment of costs
- v) expenditure which cannot be proved that it relates to a specific Qualifying Intangible Asset

It is noted that expenditure for outsourcing of R&D activities to non-related person as well as general and theoretical expenditure for R&D that cannot be directly allocated to qualifying expenditure of a Qualifying Intangible Asset, can be apportioned on a pro-rata basis to the Qualifying Intangible Assets or products.

b) Up-lift expenditure

Up-lift expenditure is defined as the lower of:

- i) 30% of qualifying expenditure
- ii) the total acquisition cost of the Qualifying Intangible Asset and the R&D cost outsourced to related parties in relation to the Qualifying Intangible Asset

c) Overall Expenditure

The Overall Expenditure of the Qualifying Intangible Asset is the sum of:

- i) the Qualifying Expenditure, and,
- ii) the total acquisition cost of the Qualifying Intangible Asset and the R&D cost outsourced to related parties in relation to the Qualifying Intangible Asset, incurred in any tax year

d) Overall Income

The Overall Income which arises from the Qualifying Intangible Asset is the gross income earned within the tax year, reduced by the direct costs incurred for the production of this income.

The Overall Income includes, but not limited to, the following:

- i) rights of use (Royalties), or other amounts, in relation to the use of the Qualifying Intangible Asset
- ii) any amount for granting license for the exploitation of the Qualifying Intangible Asset
- iii) any amount which arises from the insurance or compensation in relation to the Qualifying Intangible Asset
- iv) trading income, from the sale of the Qualifying Intangible Asset
- v) embedded income of the Qualifying Intangible Asset which arises from the sale of goods, services or from the use of any processes directly related with the Qualifying Intangible Asset

3. Qualifying Taxpayers

A Qualifying Taxpayer, is defined as a person resident in the Republic of Cyprus, or a permanent establishment of a non-resident person, or a foreign permanent establishment subject to tax in Cyprus.

These Regulations are applicable from the 1st of July 2016.

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