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New IP tax regime takes effect

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Amendments made to the Income Tax Law in May 2012 have turned Cyprus into one of the best jurisdictions for royalty and holding structures. The amended law gives Cyprus the ammunition to compete with other jurisdictions such as Luxembourg, the Netherlands, Ireland and the United Kingdom, which have already implemented similar measures.

The new regime provides attractive opportunities for structuring the exploitation of IP assets through Cyprus, in particular through the use of Cyprus-resident IP owners, especially considering the country's extensive network of double tax treaties under which foreign withholding taxes on royalty income are either eliminated or substantially reduced.

The amendments have retrospective effect from 1st January 2012.

All types of intellectual property, including trademarks, copyright, trade names, patents and registered domain names, are affected by the new IP tax regime.

Main changes

Royalties

The law now provides that 80% of the profits resulting from royalties are exempt from the 10% corporate tax usually imposed on resulting net profits. The remaining 20% is subject to the 10% corporate tax.

The new regime encourages open innovation as licensing, particularly the royalties received from licensing agreements, is now treated differently. This should lead to more licensing contracts, thus leading to superior products with better designs and improved reliability.

Even from a strict financial angle, it cannot be denied that this is highly beneficial. For example, if a Cyprus company generates royalties through a licensing agreement, these profits can be distributed by way of dividends with a minimum tax burden to non-resident shareholders, as any dividend income payable to non-resident shareholders is already exempt from tax in Cyprus.

Another key characteristic of the new regime is that damages or compensation awarded for infringement of an IP right are also included in the 80% of royalty profits excluded from corporate tax. Thus, this provides a major incentive to rights holders to protect their rights in court.

Exemption of profits from use of IP rights

The tax treatment set out above also applies to profits from the future disposal and sale of IP rights. This means that 80% of the profits for the disposal of such rights will be exempt from corporate tax. This is an extra incentive for future owners of such rights as this a way to avoid some of the tax burden.

Amortisation provisions

The new amortisation provision is competitive and extremely favourable. It provides that the cost of acquisition or development of an IP right may be capitalised and amortised on a straight-line basis over five years, giving an annual write-down allowance of 20%.

This is a considerable acceleration compared to the previous amortisation regime, under which the rates were determined by reference to 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 annual write-down allowance would be 5%. The acceleration of write-down allowances will result in substantial cash-flow benefits by reason of the deferral of tax liabilities, especially where the value of the IP asset is substantial.

Tax rate

The tax rate in Cyprus is among the lowest of Europe: the applicable tax rate will be approximately 2% on royalty profits, given the above capital allowances and the other reductions made by the amendments.

Comment
Considering all the amendments made by the new regime, as well the fact that Cyprus is an EU member state with an enviable geographical location, it is fair to suggest that Cyprus has become the ultimate royalty and holding structure jurisdiction.

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