



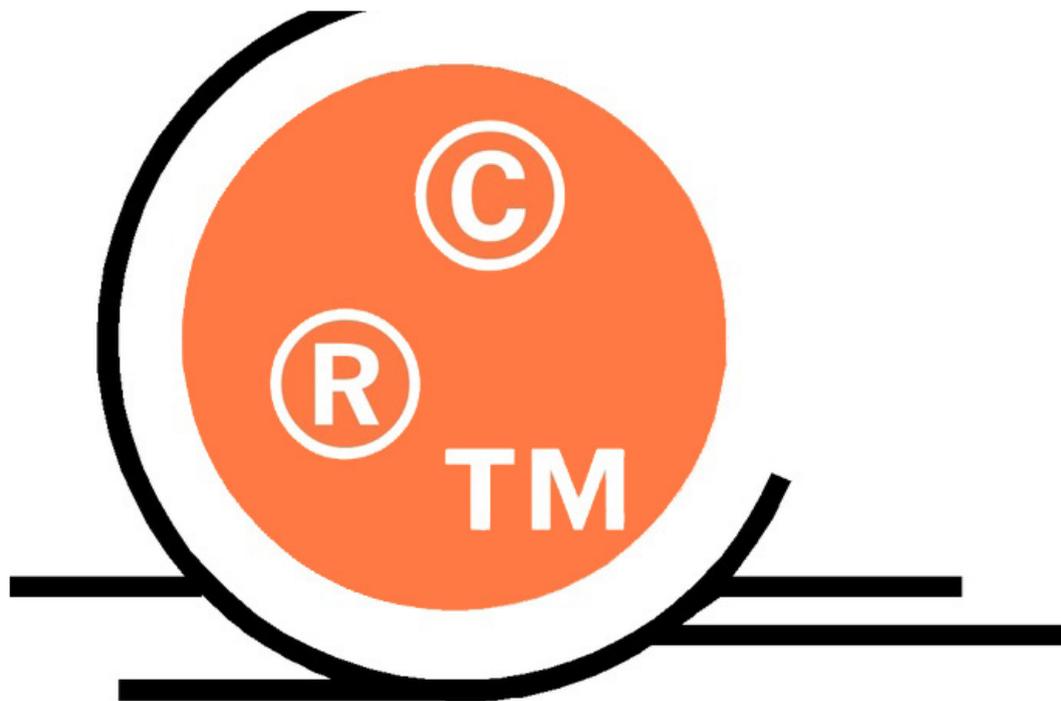
COSTAS TSIELEPIS & CO LTD

TAX UPDATE

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INTELLECTUAL PROPERTY



“knowledge”

*Facts, information and skills
acquired through experience or
education; the theoretical or
practical understanding of a subject.*

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ΓΝΩΣΗ

Intellectual Property

1.0 Introduction

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 2,5%, 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. We had previously held off publishing the update in order to incorporate certain practical considerations that have arisen since the amendment came into force. We also note that a circular is expected from the Cyprus Income Tax Office (ITO) on this topic.

2.0 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 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 as well.

There are three categories of IP:

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

Legal protection is afforded as follows:

2.1 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.

2.2 Trademarks, service marks and designs

On 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 for foreign owners.

Cyprus, being a member of the EU, enforces EU Regulation 207/2009 on the Community trade mark as well as EU Regulation 6/2002 on Community designs, offering protection at a European level.

International protection is afforded in conjunction with the International Paris Convention for the Protection of Industrial Property, to which Cyprus is a signatory.

Also, through the Madrid System for the International Registration of Marks, which is made up of the Madrid Protocol and the Madrid Agreement (these both establish an administrative process, which allows the registration of trademarks in multiple countries by using a single trademark application).

The Paris Treaty and the Madrid System are administered by WIPO.

2.3 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.

3.0 IP Tax Regime

3.1 Application of the IP tax regime

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. However the 80% deduction, from the profit detailed below, applies to IP acquired or developed before 1 January 2012, so long as the profit arises after this date. The tax regime applies also to any damages received by the IP owner for illegal use of the IP.

3.2 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 amortization allowance is tax deductible. These accelerated amortization allowances will normally give full tax relief of the cost over a much shorter period of time (5 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 12,5%.

Further tax reductions can arise 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 2,5%.

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 amortization 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 12,5%	<u>1.000</u>
Effective tax rate	<u>0,5%</u>

Example 2

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>
Profit / Gain	650.000
Less 80% statutory deduction (80% x €650.000)	<u>(520.000)</u>
Taxable profits	<u>130.000</u>
Corporation tax at 12,5%	<u>16.250</u>
Effective tax rate	<u>1,08%</u>

Note: we understand that the ITO has interpreted the legislation so that any amortization allowance previously claimed, should be added back in arriving at the profit before the statutory deduction. It is our view that this is not the case if we apply a strict interpretation to the provisions of the legislation. However, if the ITO's position was adopted, the example above would have the following tax treatment:

	€
Income from sale of patent	1.500.000
Less – cost of acquisition	(750.000)
Less - commission payment	<u>(100.000)</u>
Profit / Gain	650.000
Add back amortization 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 12,5%	<u>23.750</u>
Effective tax rate	<u>1,58%</u>

Even if this interpretation is adopted by the company, to avoid conflict with the ITO, the effective tax rate is still only 1,58%.

4.0 Other Considerations

4.1 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 recipient of the service 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.

4.2 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.

4.3 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-owing 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.

Note:

The above is issued as guidance only and should not be solely relied upon to structure business transactions without expert advice.

Helping to implement the low effective tax rate that the Cyprus tax system can offer, minimising potential withholding taxes from other tax jurisdictions, as well as negotiating with Cyprus and foreign tax authorities, will contribute significantly to minimising tax 'leakage' within a group.

Our experienced team here at Costas Tsielepis & Co Ltd, supported by our strong and capable network of associates in Cyprus and around the world, are ready to help you plan your ventures.