

'IP RIGHTS BOX' - CYPRUS 2014



“ 2.5%
tax on net
royalty
income ”

In recent years a number of EU countries have introduced schemes that can lead to substantial tax benefits in relation to license/royalty payments deriving from the exploitation of intellectual property rights. These schemes have come to be known as an intellectual property rights box ('IP box').

Cyprus by way of its IP box offers an effective tax rate of no more than 2.5% which is way below that offered by other jurisdictions (Luxembourg, the Netherlands, Belgium, Hungary and the United Kingdom).

Through domestic legislation and treaties, Cyprus provides for the highest standard of IP protection, ensuring a stable

legal framework for the owners of IP rights. Cyprus has various domestic laws which regulate IP and which are to a large extent based on English law. Cyprus has ratified the Treaty and Regulations of the World Intellectual Property Organisation (WIPO) and is also a party to various International Conventions and Treaties for the protection of IP rights.

The island's excellent infrastructure, English based legal system, and high quality of professional services combined with its well educated labour force, good industrial relations but mainly generous tax incentives create an ideal business environment. In general Cyprus offers ease of doing business in a professional environment.

Overview of Cyprus' 'IP box' scheme

Cyprus' 'IP box' regime basically provides for an 80% tax exemption of profits deriving from either the use or the disposal of intangible assets.

The main features of Cyprus' 'IP box' scheme are outlined below:

ELIGIBLE ASSETS

Cyprus law covers the following types and categories of intangible assets:

- Trademarks,
- Patents,
- IP rights (scientific work including computer software programs, literary work, musical work, artistic work, movies, database, recording, broadcast, publications)

Note: In order to take advantage of the scheme the assets (IP rights) must be owned by a Cyprus (Royalty) Company either through acquisition or development. However there is no need for the assets to be developed/registered in Cyprus.

80% TAX EXEMPTION OF PROFITS FROM THE EXPLOITATION OF IP RIGHTS

The 80% deduction applies on the profit after deducting all direct expenses, such as amortisation of the assets, interest expense to finance the acquisition or development of the assets as well as any other expenses incurred wholly and exclusively for the production of income. The remaining 20% of net royalty income in the Cyprus (Royalty) Company will be liable to a 12.5% flat rate tax.

“very broad range of eligible assets”

80% EXEMPTION OF PROFITS FROM THE DISPOSAL OF IP RIGHTS

The remaining 20% of the profit from the disposal of the assets in the Cyprus (Royalty) Company will be liable to a 12.5% flat rate tax.

Although this may prove useful, full exemption from tax on exit can also be achieved. Since Cyprus imposes no tax on the disposal of shares (with the exception of gains derived from real estate situated in Cyprus) a Cyprus company offers an ideal way of holding a subsidiary IP company. By selling the shares in the subsidiary IP Company to a prospective investor effectively allows for the tax free disposal of the intangible assets (see diagram 3 below).

ACQUISITION AND R&D EXPENSES/COSTS

The cost of acquisition or development of an IP right may be capitalised and amortised on a straight line basis over 5 years, giving an annual writing down allowance of 20%.

Research expenditure may be capitalized and amortised on a straight-line over a 6 year period.

R&D expenditure of a trading nature is expensed.

“cost of acquisition may be amortised over 5 years”

NO WITHHOLDING TAX ON DIVIDENDS PAID

Under Cyprus tax law no withholding tax on dividends will be paid by the Cyprus (Royalty) Company to its shareholders. Thus a Cyprus company can be used to generate royalties under licensing or similar agreements with third parties interested in exploiting these rights and distribute profits to its shareholders by way of dividends with minimal tax leakage.

NIL OR REDUCED TAXES ON ROYALTIES RECEIVED

Royalty income will be paid to the Cyprus (Royalty) Company with either reduced or nil foreign taxes under the provisions set by EU Interest and Royalty Directive and/or Cyprus' vast network of Double Tax Treaties (nearly 50).

AN EFFECTIVE TAX RATE OF NO MORE THAN 2.5%

The essence of the whole scheme is that when applying the Cyprus corporate income tax rate of 12.5% on the remaining 20% of net royalty income you are left with an effective rate of 2.5%. Given that all expenses incurred wholly and exclusively for the production of income are deducted before arriving at the taxable income then the overall effective tax rate should generally be well below 2.5%.

COMPARISON WITH OTHER JURISDICTIONS

Compared to the other jurisdictions that offer the same schemes Cyprus' is much more beneficial:

	effective tax rate (approx.)
Cyprus	less than 2.5%
UK	10%
Belgium	6.8%
Luxembourg	5.8%
Netherlands	5%
Hungary	9.5%

Diagram 1: Cyprus' 'IP Box' scheme compared to other jurisdictions

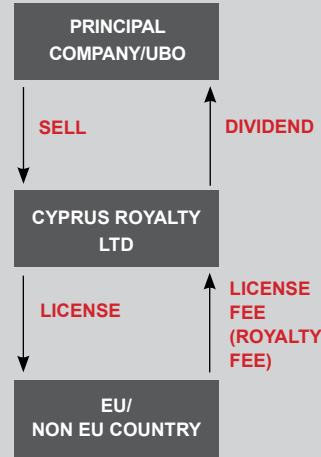
Examples of structuring possibilities

Basic Structure

An Intellectual Property owning company wishing to trade its assets anywhere in the world can do this with substantial tax benefits by structuring its business through Cyprus.

- In order to be able to take advantage of the favourable tax benefits under Cyprus' 'IP box' scheme, the Cyprus Royalty Company must be the owner of the IP right.
- Hence the foreign company sells the IP right to the Cyprus Royalty Company (the cost of acquisition may be capitalised and amortised over 5 years).
- The Cyprus Royalty Company will then license the rights of the IP to prospective clients in EU or abroad collecting royalties along the way. Royalties paid from the EU/NON EU country to Cyprus will be subject to withholding tax as per the DTAA or EU legislation.
- Utilising the scheme the Cyprus Royalty Company will be taxed at 2.5% on its worldwide royalty income.
- Likewise should the Cyprus Royalty Company decide to dispose of its rights, the profit arising from such disposal will be taxed at 2.5% (there are ways to avoid all tax here).
- Dividends paid by the Cyprus Royalty Company to the Principal Company bear no withholding tax.

“ no withholding tax on dividends paid to beneficial owner ”



- No withholding tax on dividends paid by the CYPRUS ROYALTY COMPANY to PRINCIPAL CO / UBO if income derived from sources outside Cyprus.

- The CYPRUS ROYALTY COMPANY benefits from an 80% tax exemption of its net royalty income. So it is taxed at Cyprus corporation tax rate of 12.5% on 20% of its royalty income i.e. 2.5% on its whole royalty income. Also this applies to the disposal of IP rights
 - Cost of acquisition may be capitalised and amortised over 5 years.
 - All expenses incurred are tax deductible

- Royalty income paid with nil or minimal withholding tax according to DTAA or EU legislation.

Diagram 2 Cyprus Royalty Company

How it works

An example for year 1 with numbers based on the structure above:

- €25,000 IP acquisition cost (can be amortised over a 5 year period)
- €10,000 Royalty income for year 1 received from foreign customer (with nil or minimal withholding tax)
- €500 Interest and other direct expenses (fully deductible)

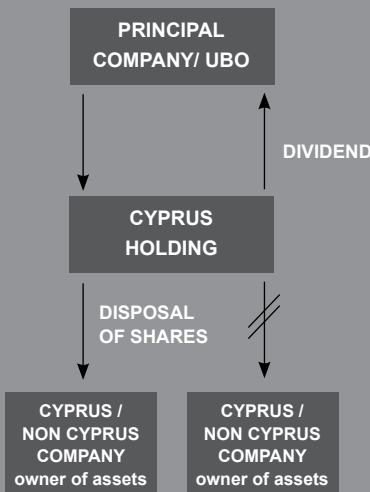
Royalty income	€10,000
Interest Expense	-€500
20% amortisation	-€5,000
Net income	€4,500
80% deduction	-€3,600
Net taxable income	€900
Corporation income tax 12.5%	€112.50

Diagram 3 Calculation of Cyprus (Royalty) Company taxable base for year 1

Exit route – Cyprus Holding Company

A Cyprus Company can be used as a Holding Company for various companies owning Intellectual Property rights for a tax free exit route.

Since Cyprus imposes no tax on the disposal of shares a Cyprus Holding Company offers an ideal way of holding a subsidiary IP Company who owns the IP rights. By selling the shares in the subsidiary IP Company to a prospective investor effectively allows for the tax free disposal of the intangible assets.



- No withholding tax on dividends paid by the CYPRUS HOLDING COMPANY to PRINCIPAL COMPANY/UBO if income derived from sources outside CY.

- No tax on disposal of shares.

Diagram 4 Tax exit route

“ tax free disposal of assets ”

Conclusion

Cyprus offers multiple benefits that are attractive to a growing number of international companies who manage brands and intellectual property across borders. By structuring the exploitation of their IP assets through Cyprus they will not only enjoy tax benefits on the income generated from the use of such rights but also they will gain access to a tax efficient exit route in the future.

Our services

- We can undertake the incorporation of a Cyprus royalty company best suited to our client's needs and requirements.
- We will propose structure ideas for creating, managing and dissolving a Cyprus royalty company.
- Advice will be provided in connection to the drafting of the Memorandum and Articles of Association, issue of share capital, composition of the board of directors and to any other matter relating to incorporation.
- Ancillary to our incorporation and consulting services we can provide administration, management and other related services.

Contact Us

Should you require any help or further information on the above we will be more than happy to assist you. Feel free to contact Martinos Typographos.



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