



1 The Intellectual Property Regime: Overview

INTRODUCTION

The Intellectual Property ("IP") rules in Cyprus are designed to foster growth in businesses that engage in Research and Development ("R&D") activities related to Qualifying Intangible Property ("QIP") assets, thereby incentivizing innovation.

The Cyprus IP rules follow the European Union ("EU") and the Organisation for Economic Co-operation and Development ("OECD") standards, rewarding entities which develop QIPs through R&D, and satisfy the 'substance thresholds' set out in Base Erosion and Profit Shifting ("BEPS") Action Point 5 (*Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*¹).

QUALIFYING IP ASSETS

Under the Regulations (Κ.Δ.Π. 336/2016), a QIP is an asset acquired, developed or used within the context of carrying out a business, resulting from R&D activities. QIPs include IP even in cases where there is only **economic ownership**. The definition explicitly excludes marketing-related intangibles, such as brands, tradenames, image rights etc.

¹ https://www.oecd-ilibrary.org/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en

Specifically, the QIPs include the following types:

- ▶ Patents;
- ▶ Computer Software;
- ▶ Utility models and other IP that are non-obvious, useful and novel (subject to specific criteria).

QUALIFYING IP PROFITS

A taxpayer under the scope of the IP rules, can claim a deemed deduction that amounts to 80% of the qualifying profits derived from a QIP. The calculation of the benefit follows the 'Nexus' approach set out in BEPS Action Point 5, which directly links the level of the benefit to the extent of the R&D activities undertaken by the claimant company in developing the QIP (either internally or outsourced to non-related parties). In a snapshot, the qualifying profits are calculated as follows:

²

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

The election to claim the deduction is optional, i.e. the taxpayer may elect to claim the full deduction or part thereof in any given tax year.

CAPITAL ALLOWANCES

Intangible assets (irrespective of whether they qualify as QIP assets, except for goodwill) are eligible for tax amortization in accordance with acceptable accounting principles, with a maximum period of 20 years. Taxpayers may elect to claim the full deduction or part thereof in any given tax year. Any unclaimed tax amortization can be evenly allocated and claimed over the remaining amortization period.

² The numerator also includes an up-lift expenditure at the lower of 30% of the Qualifying Expenditure and the total cost of acquisition of IP and the R&D outsourcing to related parties.

OVERALL INCOME

The overall income ("QA") emanating from a QIP represents the gross income less any direct or indirect expenses incurred wholly and exclusively for the generation of such income. Based on the Regulations, QA means:

- ▶ Any royalty or other sums in respect of the use of that QIP;
- ▶ Any amount for the grant of a licence to exploit that QIP;
- ▶ Any amount of insurance claims, damages or compensation in relation to the QIP;
- ▶ Income arising from the sale of the QIP, excluding any profits of a capital nature;
- ▶ Embedded IP income from the sale of products, services or the use of processes directly related to the QIP.

2 Practical Considerations

ASSESSING THE QIP INCOME

Taxpayers should carefully evaluate the income derived from the IP asset to ensure it accurately reflects the reward for R&D functions. Tax authorities emphasize that overall income under the IP regime should strictly represent the reward attributable to the R&D function.

For instance, it could be a challenge in identifying functions and other contributory assets (e.g. internally generated) that are not directly linked to R&D. In the case of marketing for example, taxpayers may consider that not all marketing activities would result in the creation of a valuable intangible. Thus, a distinction should be made between routine marketing functions and those that contribute to the development of a valuable brand name/trademark.

ECONOMIC OWNERSHIP

The term economic ownership, a key requirement for claiming the IP benefits, is not explicitly defined in the Cyprus income tax law nor in any issued Circular. As a result, it presents a challenge that taxpayers should carefully consider when structuring their arrangements. Generally, the term 'economic ownership' is understood as the effective control over an economic asset. In effect, economic ownership should be allocated to the entity (or entities) that assumes the risks and enjoys (has the right to) the rewards associated with the economic asset, based on the specific facts and circumstances.

The OECD TPG do not explicitly refer to the term 'economic ownership' in the context of intangibles. However, they emphasize that residual profits from intangibles should be allocated to the entity (or entities) that performs the functions, utilizes the assets and assumes the risks associated with the Development, Enhancement, Maintenance, Protection, and Exploitation ("DEMPE") of an intangible asset.

OECD PILLAR II

Pillar II, introduced under the OECD's BEPS framework, affects MNEs with annual consolidated revenues of more than €750 million. The rules aim to set a global minimum effective tax rate of 15% for MNEs, thereby presenting challenges for MNEs utilizing the IP regime.

As of today, Cyprus intends to proceed with the implementation of the OECD's Pillar Two global minimum tax framework. To this effect, the Ministry of Finance has released a draft legislative proposal. According to the draft legislation, effective from 1 January 2025, Cyprus elected to implement the Qualified Domestic Minimum Top-Up Tax (QDMTT) which allows Cyprus to collect the top-up tax.

3 Balancing Innovation and Compliance

The Cyprus IP regime offers a valuable opportunity for businesses to benefit from tax incentives while promoting innovation through R&D activities. However, taxpayers must carefully navigate the challenges of compliance, particularly in ensuring income allocation reflects the value of R&D functions and adapting to new international tax developments, such as the global minimum tax under OECD Pillar II. As Cyprus continues to adapt its tax laws to meet global requirements, including the introduction of the Qualified Domestic Minimum Top-Up Tax in 2025, businesses must remain proactive in assessing their arrangements to leverage the IP regime effectively while addressing emerging complexities.



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